TAB 195

Coopers & Lybrand

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September 22, 1997

To the Board of Trustees of
Allegheny Health, Education and Research Foundation:

In planning and performing our audit of the financial statements of Allegheny Health, Education and Research Foundation and affiliates (AHERF) for the year ended June 30, 1997, we considered AHERF's internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. Although our audit was not designed to provide assurance on the internal control structure, we noted certain matters involving the internal control structure and its operations, and are submitting for your consideration related recommendations designed to help AHERF make improvements and achieve operational efficiencies. Our comments reflect our desire to be of continuing assistance to AHERF.

The accompanying comments and recommendations are intended solely for the information and use of the Board of Trustees, management, and others within the organization and the Department of Health and Human Services.

Very truly yours,

Coopers & Lybrand LLP

EXHIBIT
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8-19-02

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Allegheny Health, Education and Research Foundation
Internal Control Observations

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General Overview

Fiscal year 1997 has proven to be another challenging year for the AHERF organization. Consistent with AHERF's desire to build a premier integrated healthcare delivery system, the organization continued to expand in 1997. Most notable was the acquisition of a majority of the Graduate Health System as well as the creation of Allegheny University Medical Centers (AUMC), which is now comprised of the newly acquired Forbes Health System, Allegheny Valley Health System and Canonsburg General Hospital. Additionally, AHERF continued to expand its physician network through the acquisition of physician practices including the addition of the physicians that were formerly members of the Penn Group Medical Associates. At June 30, 1997, the AHERF system had approximately 1,000 physicians affiliated through its AIHG subsidiary. Each of these affiliations and acquisitions have strengthened the AHERF system by enhancing its ability to serve its communities, but also, presents challenges relative to integrating operations and managing the financial performance of the system.

1997 was also a momentous year for AHERF with respect to entering the risk sharing arena through its contract with HealthAmerica in the Pittsburgh region. Essentially, beginning in April 1997, AHERF has assumed full financial risk for providing healthcare to approximately 260,000 lives. This contract coupled with the risk sharing contracts that previously existed with US Healthcare and other insurers has elevated the number of covered lives that AHERF is managing to over 500,000. Similar to the affiliations discussed above, entering into full risk contracts of the magnitude that AHERF has assumed presents challenges to the infrastructure of the organization.

The growth discussed above requires significant capital to be successful. This capital must either be provided through enhanced operations which provide for reduced costs to the system and increased revenue and cash collections or the acquisition of additional debt, essentially leveraging the organization's growth. At June 30, 1997, the AHERF system has outstanding debt, excluding recurring liabilities, of $1.05 billion and unrestricted net assets of approximately $570 million. Such leveraging has been necessitated because of increased costs in the management of the system, recurring investment in the physician network managed by AIHG, externally unfunded research initiatives, continuing issues with the billing and collection of revenue and funds required to support the infrastructure of the AHERF system hospitals. As a result of these issues, the management of cash in the AHERF system has been very demanding throughout the year.

As a result, AHERF has supported a portion of its infrastructure growth by entering into various operating lease commitments. While these commitments provide the necessary equipment to the organization and avoid the recognition of debt in the financial statements, they represent a cash commitment that must be managed by the system. At June 30, 1997, total lease commitments in the AHERF system were approximately $432 million versus $248 million at June 30, 1996, with an additional $100 million of commitments scheduled to close in mid-September through October 1997.

General Overview (Cont'd)

Overall, AHERF has continued with its mission of building a healthcare system that will be a preeminent provider into the next century. The next year will be a critical year as the organization must begin to realize operational efficiencies as well as revenue enhancements from the affiliations that it has consummated in the past two years, in addition to the extensive physician network that has been assembled. Additionally, medical management processes will need to be enhanced as AHERF has potentially assumed significant risk through the full risk contracts with HealthAmerica and US Healthcare. Lastly, enhancements must continue to be made to the revenue and billing systems to improve the timeliness of cash collections in order for adequate amounts of cash to be available to fund operations, capital and debt obligations.

Risk Contracting

AHERF's focus on the development of a network provides challenges beyond the traditional healthcare provider's risks. These risks include, but are certainly not limited to, negotiation of contracts with third-party payors to share in the risks of reimbursement for delivery of care to patients. During fiscal year 1997, AHERF has made a significant investment in such arrangements by assuming the risk of managing care for approximately 285,000 lives, which results in the system's covered lives to being in excess of 500,000.

In connection with building such risk pools with third-party payors, AHERF has assumed a number of additional challenges which include:

- managing out-of-network care,
- creation and maintenance of adequate information systems to provide financial and operational management with timely and meaningful utilization data,
- negotiating premium levels and understanding marketing strategies,
- reducing costs through identification of operational efficiencies,
- development of medical management policies,
- obtaining appropriate levels of insurance coverage to limit exposure to catastrophic claims, and
- managing the relationships between AHERF and third-party partners such as HealthAmerica and US Healthcare.

Management of AHERF has designated individuals that are responsible for implementing policies and procedures and for building an appropriate monitoring system for these risk agreements. The monitoring system can be characterized as evolving throughout the fiscal year. Based on the results of our current audit procedures, we noted that exposure to significant liabilities over the term of the contracts may exist if they are not managed closely.

We recommend that management continue to allocate resources, both at a finance and operational level, to monitor risk agreements, with a particular focus on premium negotiations and marketing and monitoring of medical management cost to provide care to such patients. Management should also focus on the cost of providing care both inside and outside the network, since this is an area which can also expose the organization. Finally, consideration should be given to the establishment of action plans that provide targeted goals for the system to achieve and provide a baseline for evaluation of the success of the contracts. Targets could also provide comparative statistical information as a means for benchmarking AHERF to other systems that have entered into similar arrangements. Appropriate management tools are essential in order to achieve financial success in such complex agreements.

Management Response

AHERF recognizes that the success of an integrated delivery system depends not only on its ability to coordinate care, but also on its ability to utilize resources to proactively manage health. The goals of AHERF's integrated delivery system include the creation of a continuous

Risk Contracting (Cont'd)

improvement management process and the implementation of a care delivery model which produces the best return on investment, that is, the best health possible for the covered lives for which it is responsible.

The focus of initiatives underway include:

1) The initial implementation of the integrated care management program;
2) The ongoing assessment of the program's effectiveness in achieving targeted outcomes relative to patient quality of life, patient functional status, physician practice, and financial results;
3) Collaboration with all of the components of AHERF to ensure the optimal management of patients within the Allegheny system;
4) Coordination of the communication and education plans relative to the care management program; and
5) The implementation of changes to continuously improve the effectiveness of the program.

AHERF further recognizes that in order to effectively manage the quality and cost of care for covered risk lives, the system must have access to timely, accurate, and meaningful data across the breadth and depth of the patient/provider/financial interface. The specific information services and financial reporting priorities are as follows:

a) To ensure that timely and reliable data are available from each of the payors with whom AHERF has risk contracts;
b) To provide comprehensive integrated financial and utilization analyses of the data from all risk contracts in addition to providing analyses of data from each individual payor;
c) To identify and implement an appropriate risk stratification methodology so that clinically meaningful comparative data can be provided to individual practices/primary care physicians;
d) To determine the level of automated support that can be provided to the concurrent care management functions in the short-term;
e) To improve the efficiency of providing the data to the health plans which are necessary for monitoring the effectiveness of delegated medical management functions and for claims adjudication; and
f) To define the long-term information management strategy for care management and develop the appropriate implementation plan.

Revenue and Accounts Receivable Observations

During 1997, the AHERF system has faced constraints associated with reductions in reimbursement from third-party payors and reduced cash flows from these payors. As we reported to you during 1996, the system developed a strategy associated with the centralization of accounts receivable management. This was and continues to be impacted by complexities surrounding the registration, billing and collection processes. We further reported to you last year that we redesigned our audit approach to focus on these processes, and selected a sample of patient accounts and reviewed activity through the admission, billing and collection stages within the revenue cycle of the organization. We continued this same approach during the current year.

Significant improvements were noted in the areas of patient file documentation, more timely billing procedures and assessment of the net realizable value of patient accounts. The area of registration in the Delaware Valley, however, continues to provide the organization with inefficiencies in both the billing and collection process. As recommended in the past, particularly with the increasing volume of managed care agreements and risk sharing contracts, training and education and the possible redesign of the registration process is critical to the proper management of accounts receivable.

Further, it should be noted, that the system's third-party payors, particularly in the Delaware Valley Region, continue to delay the processing of claims for payment, contributing to cash flow issues and increased levels of bad debt reserves for collections.

Given the system affiliations and other influences that the complex healthcare environment imposes, management should continue to focus their attention on providing requisite levels of training to personnel, monitoring the collection process and continuing to make improvements in the areas discussed above.

Management Response:

The improvement in the condition of patient accounts receivables during fiscal 1997 reflects the planned benefits derived from the consolidation of the billing and collection functions under a strong, central leadership.

The registration function in Pittsburgh has been under the coordinated direction of a senior director for over a year, whereas the DVR region has only recently been able to benefit from a more coordinated and focused leadership structure. Benefits derived from this structure, which are more fully realized in Pittsburgh but also underway in DVR, include:

1. **Automation**

   - **Electronic Verification and Edit Approaches** - such as HDX, HDS, Combined Bill, and Filenet (for which applications to DVR registration are currently being explored)

Revenue and Accounts Receivable Observations (Cont'd)

- **Graphical User Interfaces** - roll out of ClientBuilder (AGH) and Windows-based registration for AIHG sites

2. **Process Improvement**

- **Express Registration**

- **Use of Rejected Bill Analyses** - to modify registration procedures

3. **Structural Initiatives**

- **Training and Education** - an aggressive training program has been developed around a standardized curriculum reflecting a coordinated patient access philosophy across both hospital and AIHG points of entry. Numerous classes of instruction have been held to standardize registration practices and also to provide updates relating to payor changes, new contracts, etc.

- **Expanded Financial Counseling** - In 1997, the financial counseling staff at AGH was expanded to handle processing of patient liabilities and issues at the point of service. This front end attention is particularly vital in intercepting problems associated with the complex nature inherent in many managed care arrangements.

With the full integration of a centralized leadership presence in the DVR, cohesive structure across the various AHERF affiliated institutions will exist.

Human Resources/Payroll Observations

With increased affiliation activities during the past year, increased levels of human resources, multiple benefit plans and a variety of policies and procedures exist. As such, strains on the management of the flow of transactions in both the human resource and payroll departments can occur The payroll department continues to focus on the consolidation of payroll systems while the human resource area has restructured to identify customer service areas for their employees.

Though there have been improvements in some areas, we have noted similar findings as in prior years. Management has recognized that such findings continue to expose the organization to increased costs due to delays in the processing of information. Quarterly audits have been instituted to identify those business units which have not attempted to institute procedures to reduce such processing delays.

As indicated above, our observations, which are similar to prior years, are straining the organization both from the use of resources and cost management. A summary of our findings include:

- Several hundred manual checks are processed each month as a result of delays in the processing of employee status changes, new hire information and various adjustments/corrections within the human resources/payroll systems. There are also delays in the timely transfer of information related to employee changes/corrections between the human resource and payroll departments,

- Time card information is not always verified by the person entering the data to ensure that the information is complete and signed for approval,

- Temporary employees are not consistently monitored for re-approval within defined policy periods, and

- Reconciliations of census data used for preparation of the benefit plan liability estimates do not always occur on a timely basis.

Recognizing that the growth of the system can result in a significant increase in the volume of transactions, management should institute action plans and appropriate follow-up procedures to address the improvement of processing transactions to ensure that items, as those indicated above, do not continue.

Management's Response:

Management concurs with the recommendations.

Specifically, the Human Resources and Payroll departments will work in tandem to mitigate the delays in the processing of employees status changes. Improvements in the timeliness of processing these changes should dramatically reduce the level of manual checks prepared.

Human Resources/Payroll Observations (Cont'd)

Given the volume of time cards processed (in excess of 300,000 time cards are processed on an annual basis), management believes that the present level of incomplete time card information is acceptable, manageable and does not subject the organization to undue financial risk. However, as management continues to migrate the disparate payroll functions of AHERF's recently acquired affiliates to the centralized payroll area in Pittsburgh, internal controls will be further tightened to reduce the level of time card exceptions.

The processing of paperwork related to the retention of employees temporarily added to the payroll system (e.g., interns) is certainly an area that can be enhanced. However, numerous compensating controls exist (e.g., cost center approval of time card information, workload planning and monitoring mechanisms, budget versus actual temporary employee expense analyses performed at the cost center, operating entity and corporate levels) to ensure that unnecessary temporary employee costs are not incurred. Nonetheless, the Payroll and Human Resources departments will work together with the respective operating units to develop more effective procedures to ensure that this paperwork is processed on a more timely basis.

A number of steps have been taken to ensure that census data used for the actuarial valuation is accurate. Beginning September 16, 1997, we will be sending the actuaries a file of demographic and payroll data on a weekly basis. These files will be extracted and produced by our Information Services department. AHERF's external actuary (Hewitt) will use internal systems to load and reconcile this data and will produce the annual actuarial valuation extract from their own system. This change has the following advantages:

1. Hewitt's data will be updated weekly and, therefore, kept current with changes within AHERF.
2. This eliminates the manual download/upload processes that were necessary, which caused some of the census problems in the past.
3. Edits, errors and warnings have been developed by Hewitt which will run each time a new file is loaded (weekly). This will address issues as they arise during the year rather than a once a year, single effort approach.
4. Hewitt will be interfacing with employees and providing customer services based on this data. Therefore, multiple databases (and the necessary corrections to those databases) are avoided.

Purchasing System Observations

Transitioning of affiliated purchasing systems and improvements to the existing AHERF processes is an area that has received continued focus by AHERF management. Given that volume levels have increased tremendously and funding limitations exist, management continues to face challenges relative to the timely processing of data and monitoring of open purchase commitments and authorization levels. Such information is essential for the evaluation of cash management and preparation of internal reporting.

During our current year audit procedures, we evaluated past observations reported to you as well as updated our understanding of the internal control environment as a means for evaluating management's measures to improve the overall efficiency and control structure of the purchasing system. The following represents a summary of our observations, which are similar to those reported in prior years:

- Purchase orders are not consistently approved by authorized employees, particularly in those areas where signature approval forms have not been updated by the appropriate individuals,

- Though it does not appear unauthorized purchases are occurring, purchase orders designated for deletion are not being deleted from the purchasing system on a timely basis,

- Discrepancies between purchase requisitions, purchase orders, invoices and receipts are not resolved on a timely basis, our testing indicated that such discrepancies amounted to approximately $5.7 million, and

- Unmatched credits from vendors are not being resolved on a timely basis.

Management should evaluate current policies and procedures to ensure that unauthorized purchases do not occur within the system. Due to the dynamics of the organization, a periodic assessment, at least annually or semi-annually, of authorization levels should be performed. Additionally, timely resolution of open purchase orders, unmatched invoices and vendor credits is essential to ensure that commitments of the organization and cash requirements can be appropriately evaluated by management.

Management's Response:

Management agrees with certain aspects of the comment and is taking the following action:

- Purchase order authorization has been an ongoing problem that has been identified for the last several years. Management has implemented new policies to address this matter and additional training and monitoring is required.

- Purchase orders designated for deletion have been brought current.

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Purchasing System Observations (Cont'd)

- Resolution of discrepancies continues to be a problem. The staffing levels of purchasing will soon be addressed to hopefully improve this.

- Unmatched credits is a problem that will require additional investigation. The centralization of the Accounts Payable function away from Purchasing has increased this problem and will need investigated.

Off - Balance Sheet Commitments

As discussed earlier, AHERF has entered into significant levels of leasing arrangements in the past year. Although not recorded as debt in the financial statements, such arrangements represent substantial cash commitments into the future. It is essential that management establish a centralized monitoring mechanism over these commitments in order to ensure that they are being properly accounted for and included in required cash outlays in the cash budgets for the succeeding years. At present, management does not have a formalized process to follow when negotiating and finalizing leasing arrangements nor does management have a formalized tracking mechanism to monitor such commitments. It is our understanding that the Treasury Department is assessing the required enhancements to the existing control environment related to this issue.

Management's Response:

Management will work to formalize processes for lease negotiations and the ongoing monitoring of executed leases. Such processes are expected to include, but will not be limited to, centrally instituted and controlled master lease facilities. Development and monitoring of such master lease arrangements will focus on operational work flow, which includes input from appropriate purchasing, administration, finance, legal and treasury personnel. These enhancements will greatly improve the monitoring of usage and compliance with facility guidelines along with operating lease provisions.

Overview of AHERF Technology Systems

The Information Services department continues its efforts toward accomplishing goals defined by the Clinical Vision for Medical Management. Ultimately, the vision strives to achieve seamless systems integration and a computerized patient record, taking AHERF to the next level of healthcare computing that must be reached to allow AHERF to remain a competitive leader.

One of the key goals is to implement corporate-wide standard core transaction processing systems. By standardizing these systems across AHERF, the implementation of a computerized patient record becomes possible. As of May 1997, conversion to standard systems had been completed for five of the eight core systems identified. The Information Services department has also dedicated a significant amount of resources to the transition of the computer systems from Allegheny Valley, Forbes and Graduate.

Information Services has made progress with other key goals. These include, but are not limited to, the completion of the initial system design for creating a computerized patient record; defining business requirements for the integration of a medical knowledge bank, and supporting external connectivity with Managed Care Organizations and Pyramid Health.

Some of the systems in place throughout AHERF are supported and maintained outside of the Information Services department. These system are run by the users and are referred to as "client managed" systems.

Technology Related Observations

As part of the fiscal year 1997 audit, we reviewed the controls surrounding the maintenance and processing of selected financial systems, principally patient accounting, professional fee billing, accounts payable, purchasing, fixed assets, admissions/discharges/transfers, order entry, payroll, flexible benefits, student billing and grant accounting. Six computers, located in Pittsburgh and the Delaware Valley, are used to process these systems. Our review focused on the control procedures in place relative to the following areas:

- **Software Maintenance** - controls designed to ensure that changes to applications and system software are appropriately authorized, tested, documented, and approved.
- **Computer Operations** - controls designed to ensure that authorized programs are appropriately executed; correct versions of data files are used during processing, and processing can be properly resumed in the event of computer processing failures.
- **Security** - controls designed to ensure that security exists over programs, data and other system resources, access to application functions are assigned based on job responsibilities, and computer hardware/media are secure from unauthorized access.
- **Implementation** - controls designed to ensure that new system implementation projects entail an appropriate level of management, testing, documentation and approvals, and include procedures to ensure data is accurately converted from the old system.

Overview of AHERF Technology Systems (Cont'd)

In addition to reviewing the Information Services' policies and procedures, we executed a security audit tool, called CA-Examine, on the Pittsburgh mainframe to identify potential security exposures. The findings resulting from the use of this tool, which were not significant in nature, have been provided to Information Services management.

The following observations were noted in conjunction with our procedural testing in the Information Services department:

Disaster Recovery Procedures

A disaster recovery plan documents the actions required if critical computer systems become inoperable and necessitate using an alternative computer. AHERF's current disaster recovery plan has some sections that are not current and not all aspects of the plan have been successfully tested. Furthermore, recovery procedures have not been documented for the Accounts Payable and Purchasing systems which are "client managed" (run by user departments). This may result in an unacceptable recovery period or inaccurate recovery of data for critical hospital systems should the computer system become inoperable.

AHERF should dedicate the time and resources to ensure that the recovery procedures are updated and kept current, especially given that AHERF's environment is constantly changing. The updated disaster recovery plan should be fully tested to ensure all aspects of the plan will operate accordingly. In addition, the user departments responsible for the "client managed" systems should document and test recovery procedures for their systems.

Management Response (Information Services)

Information Services (IS) has assigned a full time management level resource to be responsible for disaster recovery planning. The responsibilities of this person include ensuring that recovery procedures are updated and kept current.

On September 15-16, 1997 we completed a successful test of our mainframe recovery plan. Using our hot site we recovered all mainframe applications and successfully tested communications and critical applications because a number of systems are not managed by IS. To ensure that AHERF is prepared for any disaster, the owners of "client managed" systems must also develop recovery procedures. We will provide assistance to these owners to develop their plans.

We are now going to focus our business recovery efforts on non-mainframe applications managed by Information Services. These efforts, however, will not ensure that AHERF can successfully recovery all critical applications because a number of systems are not managed by IS. To ensure that AHERF is prepared for any disaster, the owners of "client managed" systems must also develop recovery procedures. We will provide assistance to these owners to develop their plans.

Overview of AHERF Technology Systems (Cont'd)

Year 2000 Strategy

The year 2000 will be the first century change ever encountered by an automated society. The vast majority of computer applications in use throughout the world today have date processing logic based on a two-digit year (e.g., "97" for 1997) When the year 2000 arrives and the two-digit year becomes "00", the computer application logic and/or the operating system software may produce erroneous results or fail to operate. The efforts and associated costs to address the year 2000 issue could be significant, as existing applications may need to be changed. The time required to research, change and test existing applications (or implement new applications) is typically extremely tight given that the year 2000 is an absolute deadline.

The Information Services (IS) department has formed a committee with representatives from various areas including facility, applications, end-user computing, networking, systems, security and Internal Audit. Sub-committees have been formed to define the date compliance standards, review and recommend software packages to aid in the management of the year 2000 project and develop a communication and awareness plan for the organization. These committees have identified over 300 software products/systems which need to be Year 2000 compliant.

Although progress has been made in assessing the implications of the year 2000 issue, an entity-wide strategy has not yet been developed and the initial assessments have not included all potential affected areas outside of IS, such as client managed systems and other equipment that utilizes a microprocessor.

We recommend that AHERF management develop and implement an entity-wide strategy to address the year 2000 issue. The year 2000 project should have clear sponsors from the IS and non-IS areas. For application software provided by vendors, management should gain written assurance from the vendor that the software is, or will soon be, year 2000 compliant.

Management Response (Information Services)

Information Services (IS) has recognized the criticality of the Year 2000 project and the importance of developing and implementing an enterprise strategy to address the Year 2000 issue. As such, we have created a Year 2000 Project Office and reassigned eight full time staff to focus on preparing AHERF for the Year 2000. This group is responsible for coordinating project activities across the entire enterprise and for ensuring the integrity of the overall century-compliance effort at AHERF.

Overview of AHERF Technology Systems (Cont'd)

A management awareness campaign throughout the organization has been concluded. The Project Office staff is in the process of conducting a detailed assessment of all systems throughout the enterprise. This includes developing workshops to educate and access non-IS areas. Additionally, a member of the Project Office staff has been assigned full time to work with legal counsel to follow-up with vendors regarding compliance of packaged products (i.e. release number, ship date, compliance strategy, certification strategy).

The detailed assessment of all systems throughout AHERF will include systems managed by IS and "client managed" systems. It is the responsibility of the owners of the "client managed" systems to ensure that they are Year 2000 complaint. IS will assist in the effort and maintain an inventory of systems and their degree of Year 2000 compliance.

TAB 196

IN THE UNITED STATES DISTRICT COURT 08:33:50

FOR THE DISTRICT OF PENNSYLVANIA

THE OFFICIAL COMMITTEE OF
UNSECURED CREDITORS OF
ALLEGHENY HEALTH, EDUCATION &
RESEARCH FOUNDATION, Civil Action
Plaintiff, No. 00-684
vs.
PRICEWATERHOUSECOOPERS, L.L.P.,
Defendant.

Videotape deposition of DANIEL CANCELMI, called for examination under the statute, taken before me, Jaci R. Traver, RPR, CRR, and Notary Public in and for the State of Ohio, at the offices of Jones Day, 500 Grant Street, Pittsburgh, Pennsylvania, on Thursday, the 23rd day of January 2003 at 9:00 a.m.

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A Yes
Q. One of them is what we talked about earlier, before I was rudely interrupted, and that was the notion that there may be a arrangements with third party payors to charge some discounted or usual fee as opposed to the fee normally charged for the service by the hospital.
A. That can be one of the factors.
Q. And that makes the collection of the balance perhaps more difficult, right?
A. It can.
Q There are, in addition to that, government payors who have certain requirements of their own as to what they will or will not reimburse for and how much they will reimburse for given items, right?
A. Yes.
Q. On the self-pay portion of hospitals, a hospital is treating people who are ill or in need of treatment, regardless of their ability to pay. right?
A That happens, yes.
Q So in many cases you are dealing with the unfortunate combination of large

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hospital bills being rendered to people who do not have any third party insurance for it, right?
A. That happens, yes.
Q. And it is unusual in this particular context, because someone can't really avoid medical treatment if they need it, right?
A. I mean, yeah, that can happen. I mean there's rules that hospitals follow and there's certain, I believe, there's certain laws and regulations in terms of what services absolutely need to be provided to people, regardless of their ability to pay.
Q. But generally speaking, you're dealing with sick people who don't have -- who don't have the ability to decide whether or not they need the service, and need the service irrespective of their ability to pay, right?
A. That happens, yes.
Q. All of these things are components that are built into the healthcare system, right?
A. Yes.
Q. Okay. And the only source of -- or

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the primary source of revenue that a hospital has is its patient revenue, right?
A. Generally speaking, depending -- you can have hospitals, if they have -- if they're well endowed, that can generate vast sums of revenues from other sources, endowment investment income and stuff like that. But I mean by and large a hospital's primary source of revenues or cash receipts comes from treating patients.
Q All right. That will exhaust that area, I guess. Let me ask this question.
Was there any -- ever any discussion at AHERF about deliberately understating the allowances for doubtful accounts?
A There was at times -- there was one point where the company decided to record bad debt expense based on budgetary levels, until such time that they could get their arms around and make a final determination of what the problems were in the billing department.
And there was a lot of unusual results coming out of the billing department. There was a lot of different possible reasons

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for those results. And there was a lot of different people trying to evaluate what the problems were.
And until there -- I don't remember exactly what year, it may have been fiscal '97 when the company management decided that until we sort this out and figure out and conclude what's really wrong, we'll book to the budgeted bad debt expense numbers.
Q. This was in 1997?
A. I think so
Q. Did Coopers know about that?
A. I'm not sure if they did or not
Q. We'll return to that.
A. But that was, just to clarify, that was during the course of the year, and that wouldn't have necessarily been the year end numbers that Coopers would audit.
Q. Now, when you were at Coopers auditing AHERF year end 1994, do you recall whether or not there was a discussion going into the audit among the auditing personnel about problems with AHERF's accounts receivable?
A In 1994? Not that I remember.

Q. Do you have -- with respect to the year end audit of 1996 or 1997, do you recall having any awareness as to whether or not Coopers was attaching special significance to the area of accounts receivable in connection with those audits?

A. Yes

Q. What was that understanding and for what audit years?

A. There was a lot of -- as I mentioned before, there was a lot of concerns within the organization as to some of the problems in the billing department. There didn't seem to be the right level of cash being collected.

And the time frame, you know, whether it was fiscal '95 or fiscal '96, it really started to really become more of an issue being discussed. A lot of people within the company looking at that area, trying to figure out what's wrong. And at certain points, Coopers & Lybrand management advised Coopers & Lybrand of some of the issues related to that area.

And I know at one point AHERF

management, I believe, engaged Coopers & Lybrand to come in and do sort of, I'm not sure what the right term would be, but some type of special review or audit of some of the potential problems related to the accounts receivable area. I don't exactly remember the dates of that, but sometime in '96 or '97.

Q. With respect to the year end 1996 audit, do you know whether or not Coopers & Lybrand was attaching any special focus or significance on the account area of accounts receivable in connection with the AHERF audit?

A. I believe so, because, again, the special review that I mentioned, that may have been happening or occurring right before the end of '96 or right after.

And then it seemed like during the '96 audit, they were performing it seemed like additional work than they would have in a normal audit due to some of the issues that had been occurring.

And there would be, you know, if you look at the management letter that would have been issued by Coopers, there was, you know, certainly a rather, you know, lengthy

conversation or discussion in '96 in the management letter about some of the issues that were challenging the Allegheny organization in the patient billing area.

Q. You say if one looks in the management letter of 1996, one will find commentary about Coopers & Lybrand that challenge the Allegheny organization?

A. I'm not saying challenging, just pointing out what some of their findings were and some of the issues challenging or being presented to the Allegheny organization.

Q. All right. Now, I want to go back to something you said in your last lengthy answer, and that was it seemed like they were doing additional work, more additional work than they would have done in a normal audit. This is in 1996?

A. Yes, I believe so.

Q. Okay. On what basis do you make that statement?

A. I thought that they were asking for some more reports or data than they seemed to have asked for in the past.

Q. What sorts of reports and data, if

you recall?

A. Just -- I don't remember specifically. Just accounts receivable type information.

Q. What about -- do you remember who it was that was doing the asking?

A. There was probably a number of different people. It wasn't just one person. I think they had -- Coopers would have, you know, a number of different individuals looking at accounts receivables, so you could have a number of different people asking for data.

I think related to that special review, they sent over like a request for information from us of data that we would have to pull together.

And then I think they had people other than auditors, they had this healthcare consulting group. They had some of those people involved and went over and sat down and reviewed data in the billing department area and I guess spoke with people over there also.

Q. Do you recall a conversation with anybody from Coopers & Lybrand at or around the time of the 1996 audit in which they told you

specifically, we are really focused this year on this accounts receivable?

A. I can't remember a specific conversation.

Q. Was your impression that they were doing additional work was simply that it seemed like there was more activity from Coopers in the area of accounts receivable?

A. Yes.

Q. More requests for information?

A. Yes.

Q. All right. But nobody from Coopers was specifically telling you, we're troubled about accounts receivable, or we're locked in on accounts receivable, anything like that?

A. I mean I think it was a given that given that, you know, that there had been problems in that area that Allegheny management had identified and had brought to, you know, Coopers' attention and had asked them to come in and do some additional work or review procedures, whatever you want to call them.

So I mean certainly, you know, took on maybe more heightened sense of awareness than it would have if there hadn't been

problems or issues in that billing area.

Q. But on the healthcare auditing side, accounts receivable and the allowance for doubtful accounts would always be a key auditing area, right?

MR. RYAN: Objection.

A. I believe that would be a fair characterization that a lot of people would conclude.

Q. Were you -- I asked you this before, but I'm not sure that I remember what the answer was.

When you were at Coopers at year end 1994, you had overall responsibility as manager for items such as accounts receivable, I think that was your testimony; is that right?

A. Yes. When you're the overall engagement manager in practice, you have responsibility for making sure the entire engagement is pulled together. You might have other managers underneath you reviewing certain areas and then you rely on, you know, the work and the review procedures that they perform and that the people underneath them perform.

Q. Do you remember whether or not your

work as manager at the year end 1994 audit would specifically include inquiry into the issue of bad debt, accounts receivable and bad debt?

A. I can't remember.

Q. All right. The reason I ask the question is because you said that many would consider this to be a focal point of a healthcare audit, right?

A. Yes.

Q. An important part of a healthcare audit?

A. Yes.

Q. As opposed to tying off bonds or something like that?

A. Right.

Q. It involves in the bad debt area that thorny issue of the auditing of estimates, right?

A. Yes.

Q. And I'm wondering, in light of that and in light of the fact that you were the lead manager, if you will, on the AHERF audit, would this not presuppose that you would be involved in some direct way in the work and conclusions

being drawn by Coopers on accounts receivable and bad debt?

A. I would --

MR. RYAN: Objection.

A. I would be involved. Whether I performed the detailed nitty gritty review of every single work paper and schedule that supported those, I can't say that. I would have to go look at the work papers and see which ones I reviewed and maybe had another manager review them.

But they would have presumably kept me apprised of what the issues were. And if there was any problems, it would have been, you know, brought to my attention and they would have been, you know, obviously escalated to the partner, if necessary.

Q. You talked about the fact that Robin Schaffer would put together estimates using matrixes of the kind and percentages that we talked about earlier. Do you recall that testimony?

A. Yes.

Q. And that this is an evaluation that would go up the line at AHERF. People would

look at the accounts receivable and the estimates and they would look at the data and sort of second guess, if you will, or add their thoughts or concepts or judgments as it goes up the line, right?

A. Yes.

Q. Now, when you were over at Coopers & Lybrand, is there somebody over at Coopers & Lybrand in connection with the auditing of that column or that item that's doing essentially the same thing, i.e., looking at the data that is being relied on, looking at the numbers, and making independent estimates?

MR. RYAN: Objection.

Q. Since I'm catching an objection, my question is a broad one.

Based on your experience at Coopers & Lybrand, how did you guys go about auditing bad debt reserves at AHERF?

A. I mean the firm has predefined audit steps that are established at the start of the auditing engagement that they set forth and say, these are the steps or audit tests or reviews that we will conduct to get comfortable that the numbers are correct.

Those procedures start with lower level people, the less experienced people. Then that data is then reviewed by a more experienced person. Then it would then go up to the manager left. It would be reviewed at the manager level.

If there were multiple managers, in the '94 case there was multiple managers, that manager's review would have, may have initially been reviewed on a more cursory basis, from my perspective, making sure numbers made sense overall. And then after the managers get done with their review, the data is then submitted to the partners, who then review the data on an overall basis to make sure that the numbers made sense.

And that type of audit of a hospital, you know, the accounts receivable area is certainly important. So, you know, there's a lot of attention.

Q. My question relates, perhaps imprecisely, my question relates to the fact the allowance for accounts is an estimate.

A. Uh-huh.

Q. Necessarily it's an estimate.

Somebody is making a judgment call based upon whatever data they're basing it on as to what the number is going to be.

In many accounts that are not estimates, auditors have procedures that go back, you know, generations of how you're going to sample and test and determine whether or not you're comfortable that the numbers are fairly presented in the financial statement. But with an estimate, I'm trying to figure out how one gets their arms around that.

The company presents an estimate on their financial statement for doubtful accounts, an allowance for doubtful accounts. Right so far?

A. Yes.

Q. That's a significant item on a healthcare company's financial -- or healthcare provider's financial statement, right?

A. Yes.

MR. RYAN: Objection.

Q. Well, whether --

MR. WHITNEY: What's the objection?

MR. RYAN: Significant to whom?

Q. Is it a significant item on a

financial statement?

A. It can be, yes.

Q. It is -- it's a high risk area on the financial statement, to utilize the terminology you used earlier, right?

A. It's an area, yeah, that oftentimes is considered high risk and the auditors will spend a lot of time making sure the numbers are accurate.

Q. Now, I'm familiar with the fact that in other areas of auditing of other types of companies involving estimates, one way they approach it is they make, the auditing firm makes its own estimates and then looks at its estimates versus the company's estimates in trying to assess whether the company's estimate is a reasonable one.

And my question to you is: Is that, in your experience, what Coopers did in evaluating AHERF's estimate for doubtful accounts?

MR. RYAN: Which year are you talking about, Dick?

MR. WHITNEY: 1994 to start.

A. I don't remember every single audit

know, obviously a couple weeks or a month after, you know, the end of a given month.
Q. All right. Back to 1062 a second. We have additional bad debt reserves. And the next group here are a series of transfers totaling 21,265,000. Do you see that?
A. Yes.
Q. This, again, are Graduate reserves going to DVOG hospitals for the purpose of increasing the allowance for bad debt, right?
A. Yes
Q. And which Graduate entity transferred them is also listed here, it's 10.6 from -- yeah, 10,600,000 from Graduate, 1,700,000 from Mount Sinai and so forth. Do you see that?
A. Yes.
Q. There's handwriting down below that looked to me to be, if I can skip about six steps, general ledger references. Is that what they are, or do you know?
A. They're journal entry reference numbers, I believe.
Q. Journal entries in the general ledger?

A. Yes.
Q. Whose handwriting is that?
A. I believe that's Robin Schaffer's.
Q. But it's not yours?
A. No.
Q. Do you know under what circumstances Robin Schaffer came to record these journal entries? I'm sorry. Yes. Yes. Under what circumstances she claimed or came to record these references to journal entries?
A. I believe this is in probably sometime late summer of '98 when Coopers & Lybrand, it may have been PriceWaterhouseCoopers at that point, I'm not sure what the exact merger date was, but when they were reauditing or rereviewing, whatever the word would be, these adjustments. And they had asked questions as to the journal entries, I believe, and the number of journal entries that were made to record the transfers.
Q. This is something that Coopers raised in the summer of 1998?
A. I believe so.
Q. And Robin is -- Robin Schaffer is

providing this information ultimately for their benefit?
A. I believe so. I think a question had come up as to how many journal entries had been made to record these transfers; whether there was, you know, a handful of entries or hundreds of entries made to transfer these. And what she's demonstrating is really that there was only a handful of entries or maybe one or two per hospital to record the transfer.
Q. All right. Where did -- the first 50 million, you indicated, came from debiting goodwill on the Graduate hospitals' books, or the books of the various Graduate hospitals, before these entities were acquired by AHERF. Do you know where or how the reserves encompassed in this $21,265,000 slug, where they come from or how they were created?
A. They were also reserves on the Graduate hospital. various Graduate hospitals' books that had been created by, at that point, recording expense on the Graduate hospitals' books, I believe.
Q. For what purpose had they been

created?
A. They had been recorded for various reserve issues.
Q. Contingent liabilities?
A. Contingent liabilities or just certain obligations or things that were potentially an exposure item relating to the Graduate hospitals.
Q. Once again, this would have been before the Graduate hospitals were acquired by AHERF?
A. Yes
Q. These liabilities would have been created by essentially taking an expense at these various Graduate entities and using that as the basis to create the reserve?
A. Yes. They were either liabilities or asset reserves, like contra-asset accounts.
Q. I promise you we're going to look at them in just a few minutes. Finally, the last item in your August 21, '98 memo is the sum of $28,300,000 in reserves used to reduce contractual allowances. As someone once said, can you give me five cents about what you mean by that?

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What is the purpose, what does it mean to use reserves to reduce contractual allowances?

A Contractual allowance in the hospital business is where, if you liken it to a law firm, law firm's standard billing rate for a partner may be $500 an hour, but you agree to bill the client $200 an hour, so that difference, the 500 less the 200, is $300. It's like a discount you're giving your client.

It's similar to in the hospital business. You may charge a thousand dollars to perform some type of operation, but you agree to take, say, $300 from an insurance company So a thousand less 300, you have a $700 contractual allowance.

That's a contractual allowance in the hospital world.

Q. We touched on this this morning, or at least I did, and you at least grudgingly agreed. There are circumstances in which the hospital will bill an amount, but an insurance company will only agree to pay a certain amount for that procedure, right?

A. Yes.

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Q And in some, at least some of those circumstances, the hospital agrees with the insurer that they will not look to the patient for the difference, right?

A. Yes.

Q That spread between what you charge and what they'll pay, that spread is a contractual allowance?

A Yes.

Q Now, at AHERF, circa 1996, when you bill a patient for an item that is payable by a patient's insurance company for some discounted amount, do you show the whole gross amount as a receivable?

A I believe so. I think you need to -- you need to ask a billing person who does that every day, but I believe the charges on a bill, even the ones that go to the insurance companies, show the gross charges. I think that's a rule.

Like for example, when you bill Medicare, even though you may not get paid your gross charges, the charges -- you bill a gross charge as to Medicare, but they reimburse you based on whatever procedure is performed on

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that patient.

Q. Let me ask the question a different way that's more addressable by you as an accountant.

From an accounting standpoint, how do you deal with the contractual allowance? I mean the contractual allowance is the spread between what the company charges and what they've agreed to take --

A Right.

Q. -- for the service. At AHERF did they book the whole amount?

A The contractual allowances would either be calculated by the billing system itself, and the billing system would automatically -- let's go back to that example, the thousand of charges and they get paid 300. In a lot of cases the billing system would take the $700,000 and record the contractual allowance

In some cases if the billing system for whatever reason wasn't calculating the contractual allowance, you would have to make an estimate of what the contractual allowance was and record a journal entry for that.

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Q How do you deal with the contractual allowance on the financial statements?

A What do you mean deal with it?

Q Well, you've got in your example a thousand dollars gross and a $700 net for a $300 contractual allowance, right?

A. No, other way 700 contractual, 300 net.

Q All right.

A You reduce your revenue by the $700

Q. You reduce -- you reduce the revenue. Do you book the whole -- on the income statement, do you show the whole amount as revenue and then show the deduct as an expense?

A On the general ledger, it's both the gross charge and the contractual allowances is -- it's on there. But in usually the external financial statements, the accounting rules don't require you to disclose the contractual allowance. You just show the net number

Q. Well, all of this is prefatory to

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my question that when you're moving $28 million of Graduate reserves from the Graduate over to the DVOG hospitals to reduce contractual allowances, where is it going? I can understand --
A. It's on the line that says net patient revenue.
Q. What's it doing on that line?
A. It's reducing -- it's increasing the revenue on that line.
Q. All right. On the income statement?
A. Yes.
Q. Okay. Now, where did these reserves -- how were these reserves created?
A. They were created on the various Graduate hospitals, similar to the other set of reserves we looked at.
Q. When you say, similar to the other reserves we looked at --
A. On the previous page.
Q. -- we're talking about the 21,265?
A. That's correct.
Q. Again, these were reserves for some sort of contingent liabilities or other

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earmarked accounts at the Graduate, created at the Graduate before they were sold to AHERF, right?
A. Yes.
Q. Okay. When was the $25.265,000 of additional bad debt reserves transferred from the Graduate to the DVOG hospitals?
A. I think in May and June.
Q. Of 1997?
A. Of '97.
Q. Whose idea was it to transfer those reserves?
A. How those reserves were transferred is after our department would have prepared the financial statements for those months, those financial statements would have been distributed to management for their review. And that would have been like Chuck Morrison and David McConnell, et cetera.
And after they had reviewed those financial statements, they made the determination that, indeed, we needed to transfer additional reserves for the DVOG bad debt reserves, and that the contractual allowances on the DVOG hospitals for those

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particular months needed to be adjusted.
Q. Okay. 1997, in March and April, in each of those two months $25,000 -- $25 million of Graduate reserves are transferred to the DVOG hospitals and used to augment bad debt. And then at some point a determination is made that you need more; is that right?
A. Yes.
Q. And the decision is made to transfer in May and June, in increments in both May and June of 1997, $21 million more of Graduate reserves, in this case created through -- or created as contingent liability reserves. The decision is made to transfer them over, much like you would transfer the first 50, right?
MR. RYAN: Objection.
A. Yes.
Q. Now, you say that the decision was made by people like Morrison and McConnell; is that right?
A. Yes.
Q. Do you know whether or not Coopers & Lybrand was involved in the decision?
A. I don't know if they were involved

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in the decision at that specific point in time. I couldn't say for sure.
Q. Do you know whether or not they came to know about this transfer?
A. Yes, I believe they did know about it.
Q. How do you know that?
A. Well, there was -- we provided various documentation to Coopers & Lybrand that would have these transfers listed. these items listed on there. And then there would have been either through conversations directly with them, documentation provided to them, or documentation made available to them, that, you know, these transactions had been recorded.
Q. What documentation did you provide to Coopers & Lybrand that would have had these transfers listed?
A. And I may not have provided the documentation to them directly, but maybe it was Robin or people in her department, as far as the accounts receivable area. There is a number of different audit schedules that they request throughout the course of an audit, such as the activity in the hospitals, bad debt

A. That arrow is pointing down to the bottom of the page.
Q. That would be this handwriting below the typed text on page two?
A. Yes.
Q. All right. And this is the handwriting of Amy Frazier?
A. Yes.
Q. She's got something going on there that appears to be a breakdown or analysis of the $61,311,000 that's on line item general reserve?
A. Yes.
Q. And you see that the second line item down below appears to include $14,100,000 for PFMA?
A. Yes.
Q. Do you recall ever having a discussion with Amy Frazier in which she claimed an understanding that the $61 million of reserves that is referenced on the first page of this document included the PFMA reserves?
A. No.
Q. Do you ever recall any discussion

with Amy Frazier in which she told you she had understood that the PFMA reserves were part of the first 50 million?
A. No.
MR. RYAN: Objection.
Q. You never had such a conversation with her?
A. No.
MR. RYAN: Objection.
MR. WHITNEY: What's the objection?
MR. RYAN: If you're trying to tie that question to this document, that's completely misleading.
Q. All right. But the $50 million did not include in any way the PFMA reserves, right?
A. No.
Q. It was never represented to Coopers & Lybrand that they did, right?
A. No.
Q. Okay. In fact, the source of the $50 million was made clear to Coopers & Lybrand on at least two occasions, right?
MR. RYAN: Objection.
A. Yes. It was clear what the

$50 million was for.
Q. And the discussion of the amortization of the offsetting entry over 35 years?
A. Yes.
Q. Let me show you a document that we're going to be marking as 1069.

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(Thereupon, Deposition Exhibit 1069 was marked for purposes of identification.)

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Q. Document produced by PriceWaterhouseCoopers. Again, purports to be a listing, AHERF update meeting June 20, 1997, William Buettner, right? Is that Buettner's handwriting?
A. Yes.
Q. All right. Do you remember participating in an audit update -- an update, AHERF update meeting on June 20, 1997?
A. I can't remember specifically that meeting, but I mean this is the agenda for that meeting, so I assume I was there.
Q. Why do you assume that?

A. I generally attended these.
Q. You're familiar with what an update meeting was in the parlance of the relationship with Coopers and AHERF in connection with the 1997 audit, right?
A. Yes. Plus, I think I had a copy of this same agenda in my files.
Q. All right. Now, it says, accounts receivable and revenue items. It says, impact of Graduate reserve.
Down, about four bullets down under accounts receivable and revenue items. Do you recall the discussion of the impact of the Graduate reserve on June 20, 1997?
A. I don't remember the specific discussion. I believe it related to the fact that there were reserves established with Graduate that were transferred to the Delaware Valley Obligated Group, but I can't remember exactly what we talked about.
Q. There is a note, Pittsburgh levels down, reserves appear adequate, DV levels flat. Do you see that?
A. Yes.
Q. Do you know what that's a reference

to?
A. I guess he's referring to the bad debt levels. Or maybe -- it could be we're talking about the patient receivable levels. I'm not sure.
Q. Do you recall anybody from Coopers & Lybrand objecting to AHERF's transfer of the first $50 million of reserves from Graduate to DVOG?
A. No.
Q. If someone from Coopers & Lybrand indicated that -- or if representatives of Coopers & Lybrand were to take the position in this litigation that they did not know about the first $50 million in reserves until August of 1997, would that be true?
A. I don't believe so. I think if you look in their work papers, I think it would be clearly evident that that wouldn't be the case. Plus, the information that Allegheny provided to them I don't think would support that, nor would we just record transactions like that and not advise them of those, the magnitude of those transactions, with the hope that they don't find that out at some point during the

audit. Especially that particular audit area.
Q. Do you recall sometime in the summer of 1997, late summer, like August, Amy Frazier coming into your office and saying to you, what the hell is this all about?
A. No.
Q. Referring to these reserves.
A. No.
Q. Do you remember telling her, it's your problem?
A. I don't remember that. I've heard that -- I've heard that statement. Again, I'll go back to, you know, I was always under the understanding and impression that Coopers was aware of these transactions well before August of '97.
To assume that in August of '97 was when they first found out about it, I don't think the documentation would support that. And furthermore, if that was the case, I would assume it would have been ratchetted up to all kinds of levels within the organization. And I don't recall that ever occurring, whether my supervisor or that person's supervisor came back and said, hey, they don't agree with this

now.
There's protocol within the auditing profession that if you would find an adjustment of that magnitude that you didn't agree with, that you would have to, you know, document that and raise it with certain individuals in senior management, let alone the audit committee and those types of things. It's just not my recollection.
Q. Do you remember when Coopers & Lybrand signed off on AHERF's 1997 audit?
A. The time frame?
Q. Yeah.
A. I guess it was like probably January or February of '98, I guess. '98.
Q. So it was sometime well after August of 1997?
A. Sure. In fact, I mean one of the big holdups in the release of the audit that year was the Delaware Valley Obligated Group was in violation of the debt convenance. And in addition, I guess Graduate, the Graduate hospitals, either both of them or one of the two.
And so there needed to be extra

work done to get comfortable as to whether there would be some type of debt covenant violation and what the impact would be. And that Allegheny management had to prepare reports and present that information to some of the bondholders.
And then subsequent to that, there was a number of different months where Allegheny continued to have accounts receivable problems and there was still large amounts of write-offs that occurred after June of '97.
And we had to advise Coopers & Lybrand and there continued to be adjustments and make sure they were comfortable with these adjustments that happened after June of '97, to make sure that they were still comfortable that the June '97 numbers didn't need to be adjusted.
Q. If Amy Frazier or anyone else at Coopers & Lybrand had come into your office and told you, I didn't know about these $50 million, reverse those entries, what would you have done?
A. I would have told my supervisor.
Q. As a practical matter, what would

AHERF have done --
MR. RYAN: Objection.
Q. -- if Coopers told them, we're not going to sign off on these entries?
MR. RYAN: Objection.
A. Well, if that type of issue had arisen where they objected to numbers of that magnitude, there would have been, I assume, a number of different meetings and discussions and dialogue as to what potentially the issue is, what their position is, what Allegheny's position would be. And to sort out the issue and come to some resolution.
Q. But as a practical matter, if PriceWaterhouseCoopers in August of 1977 is telling AHERF, we are not going to sign off on $99 million of restructuring reserves being transferred to the DVOG, what options does AHERF have at that point?
MR. RYAN: Objection.
MR. TYCKO: You said 1977, but I assume you mean 1997.
Q. 1997, I'm sorry.
A. You know, the options would I guess would be determine based on whatever the

dialogue was at that point between AHERF senior management and Coopers & Lybrand as to what the ultimate issue is.
With those type of numbers, if Coopers said that they absolutely don't agree with it, you'd have to make some adjustment.
Q. You would have to -- you would basically either have to reverse those entries or you would have to issue your financial statements with a qualified or adverse opinion, right?
MR. RYAN: Objection.
A. That's probably a good possibility.
Q. My question to you, since I keep catching these objections, based on your experience on both the auditing side and the client's side, if the auditor tells the client, I'm not going to agree to transactions of that magnitude, what are the company -- the company basically has to go along with the auditor, don't they?
MR. RYAN: Objection.
A. Yeah, if you want an unqualified opinion. I mean there's a number of different things that have to happen, both from the

client's side and from auditor's side.
I mean there's representation letters, there's required communications with audit committees, there's management comment letters, there's communications indicating whether there's any disagreements with the management and the accountants.
Whether the auditors have identified any material adjustments that they had -- that they disagreed with and had to bring to management's attention. I mean there's a -- I'm probably just -- that's tip of the iceberg.
Q. But in any event, at no time did Coopers & Lybrand ever tell AHERF to reverse any of these reserve transfers, right?
A. Not that I'm aware of.
MR. RYAN: Objection.
Q. Not that you're aware of. The $50 million that was transferred from Graduate to DVOG, the first 50, did DVOG need the money?
A. Based on the calculations at that point in time, that was the conclusion, that they did need the reserves.
Q. All right. Would you have

transferred these $50 million of reserves and subsequently the other $21 million of reserves to DVOG's allowance for bad debt if you did not need the money?
A. No, I don't believe so.
Q. All right. Were there other reserves available to apply to DVOG's bad debt in March and April and May and June of 1997, other than these Graduate reserves?
A. Generally speaking, I mean I think Allegheny's position was the answer was no by and large. There may still have been miscellaneous reserves out there, but I don't think Allegheny management ever believed that there was reserves of that magnitude that were out there that would eliminate the need to make those transfers.
Q. You talked earlier about the so-called X file, this circulated schedule of reserves that was periodically circulated to various representatives of AHERF, right?
A. Yes.
Q. Including you?
A. Yes.
Q. Okay. By virtue of that X file,

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you would know, would you not, if there were available reserves, other than the Graduate reserves, to apply to the DVOG bad debt?
MR. RYAN: Objection.
A. Yeah, I mean that extra reserve file or the X file, that was an attempt to summarize at least some of the more noteworthy reserves, excess or otherwise, on the financial statements of the various Allegheny hospitals.
Q. Do you remember whether or not there was an excess contractual allowance reserves of $9 million available as of year end 1997 to apply to these reserves -- or to the DVOG bad debt?
A. Not offhand.
Q. Do you remember whether or not there was a CRA reserve in the amount of $10 million available to apply to the bad debt?
A. I don't know. I don't remember that, although that wasn't our department's area. That was the cost reporting department, government reimbursement department.
Q. Let me show you a document here.
- - - - -
(Thereupon, Deposition Exhibit 1070

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was marked for purposes of identification.)
- - - - -
Q. Let me show you a document that's been marked as Deposition Exhibit 1070. And I will represent to you that, while you're free to look at anything you want to in respect of these particular notes, my questions will be with respect to the matter that is contained on the document bearing Bates stamp number PWC 0036876.
A. (Witness reviewing document.)
Q. And the following page as well.
A. I'm sorry, what page? 876?
Q. 876 and 87.
A. Okay.
Q. Do you recognize the handwriting?
A. Yes.
Q. Have you ever seen this document before?
A. Yes, the SEC staff showed this to me.
Q. Do you know whose handwriting it is?
A. Bill Buettner's

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Q. Do you know what Mr. Buettner is about trying to do here in these notes?
A. I think what he's trying to do is reconcile the bad debt reserves between the two years
Q. Is he trying to determine whether or not AHERF's reserves are sufficient without the Graduate transfers, as far as you can see?
MR. RYAN: Objection.
A. I would -- I can't -- I mean it seems like that, but I think you need to ask Bill.
Q. Look at 877. You see he's got in a column beneath the needed 66.2
A. Uh-huh.
Q. Well, let me go through this calculation. Do you know what the old AHERF of 239.1 refers to?
A. No.
Q. Formula reserves 79.1 refers to?
MR. RYAN: Objection.
A. I can't say for certain.
Q. My question is whether or not you recognize these numbers?
A. No.

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Q. But down below in that there is, below the 66, there are a series of entries totaling 56.7. Do you see that?
A. Yes.
Q. One says, bad debt 35.2. Do you know what that's a reference to?
A. No.
Q. One says, excess, appears to be, CRA in the amount of $10 million. Do you know what that's a reference to?
A. I know what CRA means. I'm not sure exactly what reserve he's talking about.
Q. All right. Do you know what excess contractual allowance of 9.8 refers to?
A. That specific reserve that he's indicating there, no.
Q. How about legal reserve GL 1.7?
A. No. I mean I've had questions on I'm not sure this page, but I believe the previous page. That legal reserve, I think Allegheny had some reserves for some receivable accounts that were sent out to collection and attorneys were involved. I think that's what he's referring to.
Q. Well, my question is: As the

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF PENNSYLVANIA

THE OFFICIAL COMMITTEE OF
UNSECURED CREDITORS OF
ALLEGHENY HEALTH, EDUCATION &
RESEARCH FOUNDATION, Civil Action
Plaintiff, No. 00-684
vs.
PRICEWATERHOUSECOOPERS, L.L.P.,
Defendant.

Continued videotaped deposition of DANIEL CANCELMI, called for examination under the statute, taken before me, Jaci R. Traver, RPR, CRR, and Notary Public in and for the State of Ohio, at the offices of Jones Day, 500 Grant Street, Pittsburgh, Pennsylvania, on Friday, the 7th day of February 2003 at 9:00 a.m.

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MR. TORBORG: I would like to move to strike that response. It's not responsive to your question.
Q. Did you from time to time recommend to your superiors that additional bad debt expense be recorded on the books of the DVOG hospitals?
A. Based on the correspondence we sent out, yeah, the calculations were suggesting that additional bad debt reserves needed to be recorded.
Q. And you believed that the organization should record the additional bad debt expense, right?
A. We believed that the bad debt reserves, seemed like the bad debt reserves need to be increased.
Q. And did you believe that the proper way to increase those bad debt reserves was by booking a bad debt expense?
MR. TORBORG: Objection.
A. That would be one way, you could increase your bad debt reserves through recording expense, but then there's other ways bad debt reserves could have been increased.

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Whether you collect monies on accounts that had previously been written off, or if the organization had reserves out there that could be used for the bad debt reserves.
Q. During this time frame, earlier in fiscal year 1997, AHERF was booking monthly bad debt expense on the internal monthly financial statements of the DVOG hospitals to budget, right?
A. At this time frame?
Q. In the time, in the months leading up to the April 1997 memo.
A. At some point in fiscal '97, that's what we started doing.
Q. And the booking to budget is a large part of what caused the bad debt allowance shortfall, right?
A. No, there was -- I think there was a shortfall at the time when they started recording bad debt expense to budget
Q. A shortfall from the write-off of the old patient accounts receivable, right?
A. Yeah, write-offs of accounts. And plus, the fact that accounts weren't being collected and maybe hadn't necessarily been

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written off yet. Because you get both. You have accounts that get written off and then you have accounts that aren't written off, but they're getting older.
Q. Do you agree, though, that recording monthly bad debt expense to budget, rather than actually what was called for by the formula, was a factor in the growing bad debt allowance shortfall that you believe existed at the DVOG hospitals?
A. I'm sure that was a part of it, but I thought -- you would have to go back to the correspondence. There was a shortfall, or at least what the calculation would suggest was a shortfall at some point in time.
But recording the bad debt expense to budget, the background on that, I think I testified a number of different times on that, is there was unusually large activity of write-offs occurring. And there was questions going back and forth of were the write-offs appropriate or not. And there was issues in the billing department.
And what they -- what management decided to do at that point, until they got

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their arms around what was going on, was to start recording bad debt expense at budget.
Q. Did you at any time before writing this April 14th, 1997 memo recommend to your superiors that additional bad debt expense be booked at the DVOG hospitals?
A. Yeah, there's probably a lot of correspondence out there on that. There's a number of different memos, where based on the reserve calculation, that there -- the bad debt reserves would have to be increased.
Q. And you believed at this time that recording additional bad debt expense on the books of the DVOG hospitals was the technically proper way to increase the reserves, correct?
A. That would be one way. Like I said before, if there were -- if the organization had other reserves that could be used for the bad debt reserve account, that would be another way.
Q. Is one of the reasons that you wrote the memo that we've marked as Exhibit 8 to make sure that Mr. Spargo and Mr. Adamczak and Mr. Morrison and others were aware of the issues surrounding the $50 million reserve

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transfer?
A. Yes.
Q. Is it the case that you had some concerns about the technical appropriateness of this reserve transfer and wanted to make sure that there was documentation that your superiors were aware of it and approved it?
A. Yeah. And I say that in the memo that it seems like first glance, based on, you know, what I know, that, you know, this is sort of unusual. And I try to elaborate on that, and so I documented that.
Q. But you didn't create any kind of documentation of that type about sending this memo to Coopers & Lybrand, did you?
A. I think Coopers & Lybrand got this memo at some point. I don't remember exactly when.
Q. Do you remember specifically ever giving this memo we've marked as Exhibit 8 to Coopers & Lybrand, yourself?
A. Myself specifically, no, I did not. I very well could have, but I couldn't point to an exact date. It's like six years ago.
Q. You don't recall at any time, I'm

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not talking about what the exact date was, you don't recall at any time personally giving this memo to Coopers & Lybrand, do you?
A. Offhand, no.
Q. And you don't know for a fact whether anybody on your staff gave it to Coopers & Lybrand, do you?
A. It was my understanding they had this.
Q. But you don't know that for a fact, do you?
A. No, I don't. I don't know -- I couldn't -- I don't remember, hey, on, you know, April 19th they have this memo. I can't point to a specific date.
Q. And you don't know for a fact whether Coopers & Lybrand had it at any time during the 1997 audit, do you?
A. I can't say specifically a day, but my recollection was I thought they had it.
Q. That's what you were told by somebody, right? In fact, Robin Schaffer told you that, hadn't she?
A. Yeah, but I think other individuals have told me that, too.

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Q. Apart from what you've heard from other people, you have no personal knowledge about whether Coopers & Lybrand had this memo at any time during the 1997 audit, do you?
A. I can't remember specifically if I gave it to them. No, I can't. Can't point to a day.
Q. You have no other personal knowledge from any source about whether Coopers & Lybrand, in fact, had this memo during the '97 audit, do you?
A. I can't, again, I can't point to -- I thought they did, but I can't sit here and tell you exactly why I thought they did.
But, you know, it's not -- I don't know what else to say.
Q. Your understanding that they did is based on hearsay from what other people have told you, right?
A. Or but it could be based on what I knew at the time, and I just don't remember, you know, when it was, how they got it, et cetera.
Q. All right. So you as you sit here now, you can't say one way or the other whether

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you ever had any personal knowledge, or whether your understanding was based on hearsay; is that fair?
A. Yeah, I guess that's fair.
Q. Let me hand you what's previously been marked as Exhibit 203.
Do you recognize this exhibit, Mr. Cancelmi?
A. Yes.
Q. What is it?
A. It's a summary of the restructuring reserves that were going to be transferred from the Graduate hospitals to the DVOG bad debt reserves.
Q. It's a memo written by Al Adamczak dated April 13th, 1997, correct?
A. Correct.
Q. And you received a copy of this memo around that time, right?
A. Yes.
Q. And specifically what Mr. Adamczak summarizes in this memo are the entries necessary at AHERF, the parent corporation; is that right?
A. Yes.

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Q. And that's because Mr. Adamczak and his staff had responsibility for the accounting for the Pittsburgh-based entities, which included AHERF, the parent corporation, right?

A. Yeah, plus Al had responsibilities for City Avenue and Parkview Hospital.

Q. So two of the five Graduate hospitals were also handled by Al Adamczak and his staff, right?

A. That's correct.

Q. Is it the case then that Mr. Adamczak was personally involved in April 1997 in the journal entries to record the $50 million reserve transfer?

A. That's my recollection.

Q. Let me mark, please, as Exhibit 1092 a document with Bates numbers DC0915 pages 31 to 37.

- - - - -

(Thereupon, Deposition Exhibit 1092 was marked for purposes of identification.)

- - - - -

Q. Mr. Cancelmi, is Exhibit 1092 a summary of certain journal entries made to the

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books of DVOG entities in March 1997?

A. Yeah, that's what it looks like.

Q. So we can see here, for instance, on the first page a journal entry for $8 million in Graduate reserves being transferred to corporation 210, which was MCP Hospital, right?

A. I believe so, yes.

Q. And that lines up with the dollar amounts referred to in Exhibits 8 and 203, the two exhibits we just previously looked at, doesn't it?

A. Yes.

Q. And you can certainly -- you should feel free to look at the pages for the other DVOG hospitals. But do you agree that the first half of the $50 million reserve transfer, that is the half recorded as of March 1997, is reflected here in Exhibit 1092?

A. Yes.

Q. What's shown here are journal entries at the DVOG hospitals, not journal entries at the Graduate hospitals or at AHERF, the parent corporation; is that right?

A. That's correct.

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Q. So, for instance, focusing here on journal entry VO3017 at MCP Hospital, the $8 million we were just talking about, the journal entry shows an intercompany transfer from AHERF, the parent corporation, right?

A. I believe that's correct, yes.

Q. And did Chuck Lisman give you a copy of this document and write in the upper right-hand corner, "DC, summary of your entries"?

A. Looks like it, yes.

Q. And he underlined "your," right?

A. Yes.

Q. Just as Mr. Adamczak was the one who had responsibility for the recording of journal entries for the $50 million reserve transfer on the books of AHERF, the parent corporation, you had responsibility for reporting the journal entries for the $50 million reserve transfer on the books of the DVOG Hospital, right?

A. That's correct.

Q. Let me hand you, Mr. Cancelmi, what has previously been marked as Exhibit 37. Is Exhibit 37 a memorandum that you sent to

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Mr. Morrison dated May 1st, 1997?

A. Yes.

Q. And you discuss here at least three sets of adjustments to the DVOG bad debt reserve accounts that were processed in May 1997, right?

A. Yes. I guess they were recorded in March.

Q. At least as of March.

A. Right.

Q. Do you see that first sentence of the memo reads, "in anticipation of year-end reporting concerns related to the Delaware Valley bad debt reserve shortfall position, various adjustments to bad debt reserve accounts were processed in March 1997 to alleviate the shortfall."

Do you see that?

A. Yes.

Q. When you wrote, "in anticipation of year-end reporting concerns," you were referring to Coopers & Lybrand's upcoming audit, right?

A. Yeah, the year-end financial statements, yes.

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didn't have a full understanding of what all the matters were. But I mean that was a responsibility of other individuals.
Q. Which items on this schedule did you not have a full understanding of at the time?
A. I don't remember specifically every single one of them. I mean some of them stand out. Prudent Buyer reserve. Hill Burton reserve, that could be one. I don't know, you would have to go, I don't remember every single one that I did and didn't.
Q. But Prudent Buyer, Hill Burton are ones that stand out to you as reserves that weren't directly in your area; is that right?
A. That's right.
Q. Let me mark, please, as Exhibit 1116 a document with Bates numbers DC6585, pages 1 to 12.
- - - - -
(Thereupon, Exhibit 1116 was marked for purposes of identification.)
- - - - -
Q. Is this a memo, you wrote, Mr. Cancelmi, about the PFMA contract?

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A. Yes.
Q. And PFMA was the Police and Fire Medical Association?
A. Yes.
Q. And this memo is dated August 8th, 1997, right?
A. Yes.
Q. And that's after the time when AHERF had closed the books for fiscal year 1997, but while Coopers & Lybrand was engaged in doing the audit, right?
A. I wouldn't say the books are entirely closed, because Coopers & Lybrand was still doing the audit.
Q. If you could turn, please, to the second page of this document. Do you see that you list there what you refer to as two key issues that need to be addressed?
A. Yes.
Q. Do you see number one states, "given the ambiguities that exist as to whether AHERF or GHS is legally obligated for the deficits under this contract, the final determination should be made as to our official legal position on this matter."

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And GHS there is the Graduate Health System, right?
A. Yes.
Q. Is it the case that the legal advice that you received was that it was ambiguous as to who was obligated on the deficits for the PFMA contract?
MR. TORBORG: Objection.
A. Well, first of all, I don't think I would have received legal advice. I don't -- Allegheny management was, seemed like they were pretty comfortable that that obligation didn't exist. I think it was more of an issue how to deal with GHS and some of the individuals at GHS in terms of, you know, managing this process out.
When you looked at the document, at least my recollection, when you looked at the documents, it wasn't an obligation that Allegheny had assumed.
Q. Let me ask you to turn to page 7 of this exhibit. And do you see there an April 8th, 1997 memo that you sent to Mr. Spargo entitled PFMA Contract Financial Responsibility?

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A. Yes.
Q. And then do you see in the fifth paragraph there, the first sentence reads, "this issue was discussed with Mark Waxman of Foley Lardner who indicated that he did not know if SDN assumed GHS' obligations under the PFMA contract."
A. Yes.
Q. Was Foley Lardner outside legal counsel to AHERF?
A. Yes.
Q. Did you discuss this matter with Mr. Waxman?
A. I don't know if I did or not. I'll be honest, I don't even remember that name, to be quite frank with you.
Q. This memo you sent on April 8th, 1997 suggests that Mr. Waxman didn't know the answer to the question as to who was obligated on the PFMA contract, right?
A. Yes.
Q. Did you ever yourself review the legal documents for the PFMA contract?
A. I think so.
Q. And did you discuss who was

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obligated under that contract with any in-house lawyers at AHERF?
A. Me personally?
Q Yes
A I probably did at some point. Maybe in a meeting. And this issue came up a number of different times, whether it was Steve, Al. There was an Allegheny attorney -- there might have been one or two Allegheny attorneys. Chuck Morrison. I think Dr. Kaye got involved. McConnell was aware of it. I don't remember everyone who was involved, to be honest with you.
Q If we look at the list of Graduate system restructuring reserves, the attachment to your May 22nd, 1997 memo, this indicates that reserves were established for the PFMA contract in December 1996; is that right?
A. Yes.
Q. And it's about $7 million at the Graduate Hospital and about $7 million more at Parkview Hospital?
A Yes.
Q And did AHERF conclude at some point that it believed that it was not

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obligated on the PFMA contract after all?
MR. TORBORG: Objection. Asked and answered.
A Yeah, that was my recollection, that Allegheny didn't think they were obligated. You would have to look. I don't know if there was legal files or anything on that or not. That was my recollection.
Q. The fact that PFMA reserves were established in December of 1996 indicates that back at that date, someone at AHERF had assumed or believed that AHERF was obligated on the contract, right?
MR. TORBORG: Objection.
A. At that point in time, Allegheny management thought they -- my understanding, they thought they were obligated.
Q. All right. So is what happened basically that AHERF changed its mind as to the better reading of the PFMA contract in terms of who was obligated?
MR. TORBORG: Objection
A I wouldn't say that, better reading. I think, my recollection was there was information that maybe had become available

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after the initial time when it was first evaluated.
Q. And that information was a copy of the legal documents surrounding the PFMA contract?
MR. TORBORG: Objection.
A. I couldn't say exactly what it was. Further review, further analysis.
Q. So was the conclusion that AHERF finally reached as to the PFMA contract that the obligation under that contract had not been assumed in the SDN merger, but had been left behind with the Graduate Health system at that time?
A. That was my recollection.
Q. And the SDN merger occurred as of October 31st, 1996?
MR. TORBORG: Objection.
A. I think it was November 1st.
Q. So it's not the case that there was any sort of additional contract or additional legal event affecting the PFMA obligation that occurred between May 1st and June 30th, 1997, was there?
MR. TORBORG: Objection.

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A. I don't know. You would have to ask an attorney, I believe.
Q. In your August 8th, 1997 memo that we marked as Exhibit 1116, you suggest to the distribution list that a final termination should be made as to our official legal position on this matter; is that right?
A. I believe that's what I said.
Q. And you sent this to Mr. McConnell and Dr. Kaye and about half a dozen other officers or employees of AHERF; is that right?
MR. TORBORG: Objection.
A. Yes.
Q. Do you know who made a final determination as to AHERF's official legal position on this matter?
A. No.
Q. Do you know when that determination was made?
A. No.
Q Your August 8th memo suggests that it hadn't been made as of that time, though; is that right?
MR. TORBORG: Objection.
A I mean that's -- yes, that's what

it says. Although, my recollection is that, you know, management at that point I think didn't believe that was their obligation.

Like I said, what stands out in my mind, it was more of a political issue with Korman, who was the old, I don't know what his title is with the Graduate, and just a couple of the other issues.

And I don't know, you would have to -- I think Dr. Kaye would probably be a good person to talk to, or Abdelhak, or even McConnell, because there was -- I'm not sure it was necessarily the legal position as more as to maybe how they were going to deal with the old Graduate people. But I don't know. And that's maybe what I heard from Steve or Al.

Q. The PFMA reserves were transferred from Graduate to DVOG in the June 1997 close, weren't they?

A. Yes.

Q. So that by the time you wrote this August 8th memo, they were no longer on the books at Graduate, right?

A. That's correct.

Q. And I think based on the discussion

we had previously with reference to your June 20th, 1997 memo about the intangible assets on the Graduate entities, the $14 million for the obligation under the PFMA contract was capitalized as an intangible asset at the Graduate entities, right?

A. Yes.

Q. When AHERF decided that it was no longer obligated on the PFMA contract, wouldn't the proper accounting have been to reverse the $14 million reserve against goodwill at Graduate?

A. You'd probably have to ask someone to come in and evaluate that. In this issue, I mean we discussed this with Coopers & Lybrand. This was specifically raised. Management, you know, decided to transfer it, and the issue came up with Coopers --

Q. And Coopers & Lybrand --

MR. TORBORG: I think he was still answering the question.

Q. I'm sorry, I didn't mean to cut you off.

A. This issue was brought up with Coopers & Lybrand. It was my recollection

that, you know, they were aware that the reserves had been transferred. And they asked for documentation as to why we didn't think it was -- it wasn't needed any more. And I thought we had given them at least some information on it, but I don't remember exactly what.

Like this memo is probably an example of something that may have been provided to them.

MR. RYAN: I'll move to strike the last portion of that response as not responsive.

MR. TYCKO: Just for record, the memo that Mr. Cancelmi was referring to is Exhibit 1116.

Q. Thank you. Coopers & Lybrand suggested to you that the proper accounting treatment for the PFMA contract, AHERF believed that it was no longer liable on that contract, would be to reverse the $14 million against goodwill, didn't they?

A. I don't remember that.

Q. You're not saying that that didn't happen, are you? You're just saying that you

don't recall either way?

A. That's correct.

Q. And I take it that you remember discussing with someone from Coopers & Lybrand the question as to whether AHERF was obligated on the PFMA contract or not; is that right?

A. Yeah. Yeah, I mean generally speaking, I remember that.

Q. Do you remember with whom from Coopers you discussed that?

A. I thought I discussed it at one point with Amy. But, you know, I know that was on an audit agenda schedule that Coopers provides. So there could have been others. I can't say specifically everyone who I would have discussed it with.

Q. But the particular conversation that you do recall is one with Amy Frazier, right?

A. It seems like that. But, again, I couldn't say exactly when. I've testified to that quite a number of times. And I thought it was Amy, but it could have been others.

Q. Was that part of a conversation with Amy Frazier where you and she were going

through this schedule of Graduate system restructuring reserves attached to your May 22nd, 1997 memo?

A. I don't remember. Could have been, but I don't remember specifically. If you're asking this schedule, this May 22nd schedule, it could have been -- the components on here could have been discussed before they were subsequently discussed again in connection with this PFMA contract.

Because these issues here on the May 22nd memo have been out there for months. And, you know, I thought at certain times Coopers was asking about, you know, some of the restructuring reserves recorded on the Graduate books.

So, you know, this schedule here very well could have been discussed, you know, before the follow-up issue was discussed related specifically to the PFMA contract, but I don't remember specifically.

Q. And is it the case that in the conversation that you had with Amy Frazier about who was obligated on the PFMA contract that you don't remember the details of what the

two of you discussed in that conversation?

MR. TORBORG: Objection.

A. That would be fair. I don't remember the specific conversation.

Q. You can't testify, can you, that you specifically used the words "transferred to DVOG," can you?

A. No, I can't. I can't say that specific sentence I said from six days ago, let alone six years ago. But it's my general recollection that the transfer, the PFMA reserve was discussed, but I can't sit there and say, yeah, six years ago these are the exact words I used.

Q. Is it possible you used words like, moved to bad debt?

A. Like I said, I can't say exactly what I said. I don't remember.

Q. But that's one series of words that you could have used to Amy, right?

MR. TORBORG: Objection.

A. I have no idea, to be honest with you. I mean I don't remember the exact sentences I used in that conversation.

Q. And do you remember Amy Frazier at

some point telling you that Coopers & Lybrand believed that AHERF might still be liable on the PFMA contract?

A. I think probably when they first looked at it, they, you know, they probably said, well, we need to research it or look at it ourselves. But, again, I don't remember exactly what she said either.

Q. I want to come back to this issue about what the appropriate accounting treatment would have been for the PFMA reserve, if AHERF believed it wasn't liable on that obligation.

I think you testified previously in purchase accounting there's a one-year look-back period for the purchase price allocation; is that right?

A. For certain things.

Q. And I think you drew a distinction earlier between a change in the estimate of a liability that should be on the books in purchase accounting as a result of circumstances that occurred between the opening balance sheet and year end, on the one hand, and on the other hand, a change in estimate as to the liability that existed originally on the

opening balance sheet date. Do you recall that?

A. Generally.

Q. And in the case of the PFMA obligation, we're talking about a change in the estimate as to the liability that originally existed as of the opening balance sheet date, aren't we?

A. I guess it's change in estimate or change in facts and circumstances. Change in management's assessment of the situation. I'm not sure what you specifically characterize it as.

Q. Even if the change in management assessment took place after May 1st, 1997, it was an assessment of the situation already existing as of the opening balance sheet date, wasn't it?

A. The matter existed as of the opening balance sheet date.

Q. And that situation, you're aware as a CPA, who is experienced with purchase accounting, that the appropriate accounting treatment for a change in assessment of that type would be to reverse the reserve against

goodwill rather than release it afterwards, right?

A. Every situation is unique. I guess you have to go back and analyze each situation specifically, so I don't think you can make a general characterization like that.

But I can tell you, you know, AHERF management viewed it as based on the fact that, you know, whatever you want to call it, change in estimate, change in management assessment, change in facts and circumstances, that, you know, it was similar to the other reserves, such as the 50 million that had been established on the Graduate and then transferred to DVOG for bad debt reserves.

Q. When you say AHERF management viewed it that way, who are you talking about?

A. Well, I mean the people making the decisions, McConnell, Morrison, Adamczak, I guess at the time.

There's a number of people who were involved in this. I mean you see the distribution. Dr. Kaye got involved. I can't remember, somehow he got involved. Bob Matthews, obviously, had ties. He was an old

Graduate person, so he obviously had ties. McNair was legal guy. Harrington was the managed care contract person. Matt Dowling was the CFO of Graduate hospitals.

Q. You're looking at the distribution list to your August 8th memo marked as Exhibit 1116, correct?

A. Yes.

Q. In that memo you don't state that the PFMA reserve has been transferred to DVOG, do you?

A. I don't know if I do or not. No, it doesn't look like it.

Q. Even though the reserve had, in fact, been transferred by that time, right?

A. I believe it had been at that point, yes. But most of those individuals on that distribution list would have known at that point that it had been transferred. I think we looked at exhibits yesterday, like the preliminary financial statements for Delaware Valley that McConnell had seen, Dr. Kaye had seen. Matt Dowling was the CFO. Al Adamczak, obviously. Chuck Morrison.

As far as McNair and Judy, you

know, I don't know if they knew or not.

Q. Is there any reserve on this list of Graduate system restructuring reserves attached to your May 22nd, 1997 memo for which you're aware of a change in circumstances between May 1st and June 30th, 1997?

(Record repeated.)

A. Any?

Q. Yes.

A. I wouldn't know specifically every one. I mean --

MR. TORBORG: I'm going to have to --

A. Some of the things, I guess, that may stand out would be, you know, it's like write-off of maybe the patient receivables greater than 180 days. Like I said, I think the Prudent Buyer, there was some changes going on there. Inventory, I thought there may have been -- they may have done a physical by that point.

NIH, I thought something in that issue may have been resolved. I don't know about the miscellaneous receivables, if something was done on that.

Again, at the bottom there's Prudent Buyer again, Hill Burton. I thought that was resolved. That had been resolved. PFMA, just talked about.

Malpractice, I thought there was -- based on the June 30th, you know, reserve position that they hadn't necessarily been neither or some of it. And we've talked about the MA reserve. I don't know, it's some of the ones that stand out.

Q. With respect to the Prudent Buyer reserve, is the change in circumstance that you're referring to what you testified about earlier that the Prudent Buyer provision was removed from Independence Blue Cross contracts in the Philadelphia area?

A. I don't know if it was removed, or -- you need to talk to Steve or maybe Joe or Chuck Morrison about the reimbursement.

Q. All right.

A. Something was going on. Something happened there.

Q. All right. But the issue that leads to the change is something about the Prudent Buyer clause in the Independence Blue

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Cross contracts?
A. That could be one of the issues.
Then there could be just an issue just based on, you know, subsequent analysis of -- I don't know, the activity, maybe, after a certain point in time something changed. I don't know. I'm not the person to ask.
Q. Is Mr. Spargo the person to ask?
A. I think Steve would be a good person to talk to. Maybe Joe Scharf could help.
Q. Now, Mr. Spargo wasn't at AHERF for all of the period from May 1st to June 30th, 1997, was he?
A. No, he wasn't. He has a pretty good understanding of what the issues were related to Prudent Buyer.
Q. Isn't it a fact, Mr. Cancelmi, that the change in the Prudent Buyer provision occurred before May 1st, 1997?
A. I don't know if it did or not.
Q. That would affect the accounting treatment, wouldn't it?
A. I don't know if it would or not.
Q. You know that whether it occurred

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before or after May 1st, 1997 would affect the need for the reserve as of the opening balance sheet date for the entry into the AHERF system, right?
A. Depends what the issue was and why it changed.
Q. What change in circumstance between May 1st and June 30th, 1997 did you have in mind for the write-off of patient accounts greater than 180 days?
A. Could be something as simple as when you're looking at the status of the receivables, the aging categories. After a certain point in time, if there hasn't been a significant deterioration, that could be one, one example.
And my recollection was Graduate wasn't having -- their billing department, I think at that point, was separate from the billing department that was in Pittsburgh. And their billing department wasn't having the type of issues that the Pittsburgh billing department was having.
Q. Do you recall specifically any change at the Graduate Hospital in the need to

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write off patient accounts that occurred between May 1st and June 30th, 1997?
A. Specifically, no. Just what I said, I think based on you keep looking at the status of the receivables.
Q. We saw from the X files that we looked at yesterday that you and Mr. Adamczak were the ones who were going through the lists of reserves on the Graduate entities to identify ones that could be transferred to DVOG, right?
A. We were, I guess, one of others. Those issues on those lists were widely known by a number of different people.
Q. All right. But the only people's handwriting we saw on the X files we looked at yesterday were yours and Mr. Adamczak's, right?
A. Yes, because he probably pulled it from either Al's file or my files. Those documents are distributed to a lot of other individuals, too. If you pulled their files, you might see their handwriting on it, too.
Q. All right. And you're talking about other individuals within AHERF, right?
A. Yes.

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Q. Let me hand you, Mr. Cancelmi, a copy of the transcript from day two of this deposition. Could you turn, please, to page 321.
A. Yes.
Q. Now, I would like to read to you the question and answer that begins on line five.
Question: "How about prior to Coopers & Lybrand signing off on the 1997 audit? And by signing off, I mean the issuing of their opinion to the 1997 audit."
Answer: "My recollection is that certain of the reserves that were included in the $28 million transfer, the questions had come up to as to where those reserves had gone. And the ones that come to mind are like maybe the PFMA reserve, I think the MA, there was an MR reserve or a Hill-Burton reserve.
"I can't say specifically exactly which reserves may have been discussed. But there was certainly a number of reserves that were out there on the Graduate books. But then on June 30th, they weren't there anymore, because they had been transferred and were

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included as part of the 28."
Did I read that transcript right?
A. Yes. I think there's an error on line 14.
Q. That was exactly what I was going to ask you about first. There's a reference there to an MR reserve. Do you know what you said there?
A. I think I meant to say MA, or maybe it was I did say MA, just wasn't typed.
Q. All right. So the three reserves that you mentioned there in your answer were the PFMA reserve, the MA reserve and the Hill Burton reserve, right?
A. Yes.
MR. TORBORG: I'm going to object.
Q. Let me ask that question again.
The three reserves that you mentioned in the sentence on lines 12 to 15 are the PFMA reserve, the MA reserve and the Hill Burton reserve, right?
A. Yes.
MR. TORBORG: Objection.
MR. RYAN: Can you tell me what your objection is?

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MR. TORBORG: Since I can't remember exactly what he says, it's possible the MR could have been something like AR reserve.
THE WITNESS: Good point.
MR. TORBORG: I'm reserving the objection. He may have identified four and the record is not reflecting all four because MR is not one we've familiar with. It may have been a transcription error.
Q. Thank you. But you believe that MR was just MA, right?
MR. TORBORG: Objection.
A. That was initially what came to my mind. The AR reserve, that may have come up. I can't remember. I don't remember specifically.
Q. Have you discussed the PFMA reserve, the MA reserve and the Hill Burton reserve with Robin Schaffer since the bankruptcy?
A. Sure.
Q. And she's told you that she believes that those three reserves were brought up with Coopers & Lybrand, right?

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A. She -- I mean she's indicated that PFMA that came into ask her about it, but she said something, I don't know anything about it, you've got to talk to Dan. The MA reserve, I can't remember if she said she talked to them about that or not. And the Hill Burton could be the same as the PFMA. I don't know whether she had documentation on it or not.
Q. But all three of these reserves are accounts receivable reserves, patient accounts receivable reserves that were within Robin Schaffer's area, right?
A. Yes.
Q. And since all these investigations and lawsuits began, you and Ms. Schaffer have had occasion to discuss these three reserves; is that right?
A. Yes. Well, specifically those three reserves? Sure, they've come up, but those aren't the only three reserves that have ever been discussed.
Q. You don't have a specific recollection of you personally discussing the Hill Burton reserve with anyone from Coopers & Lybrand, do you?

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MR. TORBORG: Objection.
A. Specifically, no. I think I've said that. I think I've said from back in 1998 or 1999 that, generally speaking, I remember that there were certain reserves that had been discussed, but couldn't say specifically a hundred percent certainty that every single component had been.
And that was the basis for that one schedule that summarized the 21 and the 7, which equalled the 28. And we provided that to PWC, Mel or Rob or whoever else was there.
So that was my general recollection from way back then. And that's what I've indicated throughout the next four or five years. Then I've subsequently seen at least some correspondence in Coopers & Lybrand's firm work papers that would, I think, support that.
MR. RYAN: I move to strike the last portion of that response.
MR. TORBORG: I object to the motion.
Q. And just so we're clear, you don't specifically recall you personally discussing the Medicaid reserve with Coopers & Lybrand

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either, do you?
A I can't remember a specific conversation, but I thought that had come up, because we had received some correspondence and we had started to be paid on those Medicaid accounts.
And I think Ron Longabucco, who used to run the billing department, either had conversations with us, or we advised Coopers & Lybrand to call Ron Longabucco, because they knew Ron Longabucco And we, either myself or Robin or maybe someone else may have tried to explain that situation.
Joe Scharf was involved with those MA reserves, too And eventually, we had received it in correspondence or discussed it with Ron Longabucco that this matter had been resolved.
And we -- now that I think about it, it comes to mind, I think we -- I may have told a Coopers & Lybrand representative to maybe call Mr Longabucco if they needed more information related to the MA reserve. But I can't say specifically with a hundred percent certainty. But that seems to be, generally

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that just popped in my mind.
Q. That has nothing to do with the transfer. That's just for need of the reserve?
A. No This would have been after the reserve had been transferred, why it wasn't needed anymore. I wouldn't have had them call Ron Longabucco in the summer of '97 as to why it initially had been recorded, because I believe Coopers & Lybrand, this issue had come -- this is one of the first issues that came up during the due diligence process, which Coopers & Lybrand was actively involved in that due diligence process.
In fact, maybe, if you speak with Mr. Scharf, there could have been Coopers & Lybrand reimbursement people that got involved in assessing the situation, but I couldn't say that for certain.
MR. RYAN: Why don't we go off the record to change the tape.
VIDEO TECHNICIAN: We're at the end of tape four of deposition of Daniel Cancelmi, February 7, 2003. We'll resume with tape five. The time is 10:09
(Brief recess.)

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VIDEO TECHNICIAN: We are resuming the tape five of the deposition of Daniel Cancelmi on February 7th, 2003 The time is 10:31 a m.
MR. TYCKO: Just before you go to your next question, before the break you were asking Mr. Cancelmi some questions about the three or maybe four reserves that he had mentioned on page 321 of his January 4 deposition. Just one thing that he wanted to add on that point before you move to your next question Why don't you go ahead
THE WITNESS: I think before the break we were talking at some point about some of the reserves that that were issues that were changed or what have you.
One of the things I think we talked about was Prudent Buyer And what just what I remembered was that that contract with Independence Blue Cross I'm pretty certain included a clause that the company's management had to engage their external auditors to perform some type of review over the Prudent Buyer information.
And it was, I believe, there had to

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be a separate opinion issued by Coopers & Lybrand evaluating the Prudent Buyer information.
And I know that Coopers was involved and had been performing work in connection with that separate audit requirement. But I think Steve Spargo or Joe Scharf probably could provide more information on all the work that Coopers & Lybrand was being required to do on that, as part of that requirement of that Blue Cross contract.
MR. TYCKO: And I apologize, my introduction to that was confusing. That actually doesn't relate to questions you were asking about the transcript. It relates to the questions you were asking him about the schedule attached to Exhibit 154.
Q. Thank you. It is the case, isn't it, that the first period in which Coopers & Lybrand performed agreed upon procedures relating to Prudent Buyer obligations at Graduate was for fiscal year 1997, right?
A I don't remember. You need to talk to Steve or Joe.
Q And isn't it the case that Coopers

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& Lybrand was not retained to do that agreed upon procedures work until early in calendar 1998?

MR. TORBORG: Objection.

A. Well, I don't know exactly when they were retained, but they -- Coopers would have been aware, because I believe they had been performing Prudent Buyer agreed upon procedures work or whatever type of work they were performing before fiscal '97 time period. But I don't know the exact dates.

Q. Isn't it the case, though, Mr. Cancelmi, that other independent accounting firms, not Coopers & Lybrand, were performing agreed upon procedures relating to Prudent Buyer obligations at Graduate in 1996 and prior years?

A. They were, yeah, Deloitte & Touche was Graduate's auditors up until the time of the merger.

Q. Now, I believe you testified yesterday that you made or directed others to make the journal entries for the $28 million transfer of reserves from the Graduate hospitals to the DVOG hospitals; is that right?

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A. Yes

Q. And when you made those journal entries, or directed others to make them, what basis did you have in Generally Accepted Accounting Principles for that transfer?

A. That was based on, you know, Allegheny management had determined that those reserves would be transferred, should be transferred. And it seemed to be consistent with the methodology that had been used for the 50 million and the 21 million.

Q. Isn't it the case, though, that you were responsible for the timely and accurate preparation of the financial statements in accordance with GAAP?

MR TORBORG: Objection.

A. Yes. We went through this yesterday. To the extent I could at my level, yes

Q. It's also the case that you were not permitted to subordinate your judgment to that of others, right?

MR TORBORG: Objection.

A. Yes

Q. So when you made or directed others

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to make those journal entries, you must have formed a view as to whether they were in accordance with GAAP, right?

A. I don't know if I specifically -- I think my recollection is, based on the information that was available to me, and the rationale seemed to be consistent with how other reserves had been handled, that it didn't seem to be a problem.

Q. The $28 million reserve transfer was different from the other reserve transfers in that the transfer went into an income statement account at the DVOG hospitals, right?

A. Yeah, but that's just -- that's really semantics, because the 50 and the 21, those could have been -- those accounts, they were transferred over for. They could have just as easily been written off to the income statement and the reserve transferred over, and then the impact of the write-offs to the account handled in the same manner as the 28. I've testified to that before.

It's just a little bit different on how the patient billing department handles certain of the write-offs versus others.

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Q. That doesn't make any sense to me. The $71 million reserve was transferred to a balance sheet account, right?

A. That's because when they wrote off the accounts, they wrote off the accounts to the balance sheet account, as opposed to the 28 million, the accounts were being written off to the income statement account.

But if the other $71 million of accounts had been written off to the income statement, it would have been handled in the same manner. You would have reversed the expense of an impact, just like the 28.

Q. I'm not talking about the write-off of accounts. I'm talking about the transfer of reserves. The way the reserves were transferred was different, wasn't it?

MR. TORBORG: Objection.

A. Certain of the entries were different, but as far as the overall logic or rationale, it's the same thing.

Q. With respect to the $28 million reserve transfer, what write-offs are you talking about?

A. There was write-offs, you know, in

the patient revenue system.
Q. What write-offs in the patient revenue system?
A. I don't know how to answer that. Accounts that had been written off in the patient revenue system.
Q. You testified yesterday, didn't you, that the reason for the $28 million reserve transfer was that your superiors in AHERF management were dissatisfied with the preliminary financial results and directed the reserve transfers to improve the bottom line. Didn't you testify that way?
A. You also showed me an exhibit, or at least a number of exhibits that indicated that the explanation for those unsatisfactory results were as a result of write-offs to the patient billing system.
And I think if you go to a memo that was written from Adamczak to McConnell, there's blatant explanations that the unsatisfactory results is due to the write-off of accounts.
Q. Are you referring to what were known at AHERF as out-of-period adjustments?

A. That could be part of them.
Q. Could I ask you, Mr. Cancelmi, please, to refer back to Exhibit 1097.
A. Okay.
Q. Is the memo from Mr. Adamczak you were just now referring to obtained in this exhibit?
A. Yes.
Q. Which memo is that?
A. July 18th memo from Adamczak to McConnell.
Q. So that's on pages 65 and 66, using the Bates pages in the right-hand corner?
A. Yes.
Q. And Mr. Adamczak reports there that inpatient service revenue to DVOG hospitals was $15.7 million below budget for the month of June, right? On Bates page 65.
A. Yes
Q. And that's before the adjustments that included the larger portion of the $28 million reserve transfer, right?
A. I believe that's correct.
Q. On the next page, Bates page 66, Mr. Adamczak reports that $8.2 million was the

result of volume variances, right?
A. Yes
Q. And then Mr. Adamczak reports that at MCP Hospital there was $1 million of contractual adjustments posted in the SMS system in June which were in final billed in the previous month and should have already been at net. Do you see that?
A. Yes.
Q. Do you have an understanding as to what that means?
A. Yes
Q. Could you explain that for us, please?
A. Just what it says.
Q. What was the SMS system?
A. Billing -- patient billing system.
Q. Contractual adjustments refers to a contra revenue item?
A. Yes.
Q. So Mr. Adamczak stating here that $1 million of contractual adjustments were taken at MCP Hospital in June when the gross revenue relating to those accounts was recognized in May or another prior month?

A. Yes.
Q. Now, ideally, in a hospital accounting system, the gross revenue and the associated contractual adjustment would be recognized in the same period, right?
A. That's correct.
MR. TORBORG: Objection to the question.
Q. And there are numerous complications that sometimes make that difficult to achieve; is that right?
A. Yes.
Q. Is it your understanding that other hospital systems besides AHERF also deal with this problem with out-of-period contractual adjustments?
MR TORBORG: Objection.
A. Yes.
Q. AHERF isn't unique in this regard, is it?
MR. TORBORG: Objection.
A In dealing with this issue?
Q. In having an issue of out-of-period contractual adjustments?
A. No, they're not necessarily unique.

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Q. So you read through APB-16 as an aid in making the purchase accounting decisions, right?

A. I'm sure I did at some point. I don't know about every single paragraph.

Q. And there's nothing in APB-16 that would permit the transfer of purchase accounting reserves to an income statement account at an existing affiliate, is there?

A. There's a lot of things that aren't in APB-16 related to purchase accounting. The standards don't list every single possibility for a purchase accounting item. So you can't just make an overall characterization that because a single issue is identified in an accounting standard, that it's not appropriate.

In fact, a lot people would suggest, in fact, the profession I think would like the accounting standards to become even more specific, because they're too textbook. So there's a lot of, you look at all kind of accounting standards, every single possibility is not always specifically addressed in accounting standards, and that's intentional.

And you can't foresee every single

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situation for every company in this country, otherwise, you would have accounting standards that would be -- every single one of them would be a telephone book. And then you still wouldn't be able to get every situation in there.

Q. Did you look in APB-16 to see whether it provided any support for the $28 million reserve transfer?

A. I don't remember if I did or not.

Q. For lots of other accounting issues that arose at AHERF, you did consult the relevant accounting standards, didn't you?

A. Depends on what the issues were.

Q. We've looked at memos you wrote on sale/leasebacks where you went and consulted the relevant accounting standards, right?

A. Yes.

Q. We've seen that you consulted APB-16 itself in making the purchase price allocation decisions, right?

A. Certain of them.

Q. And this $28 million reserve transfer was an accounting transaction of a type that you had never seen before; isn't that

1065

right?

A. I guess so. Oh, I had. I saw it before, a couple months earlier, with the 50 million.

Q. But that was, different because that --

A. No, it wasn't.

Q. -- a transfer into a balance sheet account, right?

A. No, it wasn't.

MR. TORBORG: Objection.

A. Same logic. Just a manner of how the patient billing department handled a write-off of the account, that's the only difference.

Q. But you can't identify any $28 million of accounts that were written off, can you?

A. I think --

MR. TORBORG: Objection.

A. -- if you hired someone to go in and conduct an audit of the thousands of transactions processed within the billing system in AHERF in fiscal '97, you could easily find $28.3 million of adjustments. But I would

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let someone else embark on that endeavor.

Q. I'm not interested in hiring anybody after the fact. I'm interested in what you knew back in the summer of 1997. You didn't know of any $28 million in patient account write-offs that were being covered by the reserve transfer from Graduate, did you?

MR. TORBORG: Objection.

A. I wouldn't necessarily say that.

Q. You can't point to any document that lists 28 million dollars in such write-offs, can you?

MR. TORBORG: Objection. This has been asked and answered more than once.

A. I think if you go back through documents every month, you could find $28.3 million, but I mean I think you need to ask the people in the patient billing department to identify those.

Q. Let me hand you, Mr. Cancelmi, what's previously been marked as Exhibit 321. I think you testified a little bit about Exhibit 321 previously.

This is a packet that you provided to individuals from PriceWaterhouse in the

summer or fall of 1998, right?
A. Yes.
Q. And the first page of this exhibit, that is, the schedule on the cover page, is something that you and your staff prepared especially for that purpose, right?
A. Yes.
Q. This schedule didn't exist back during the 1997 audit, did it?
A. That's correct.
Q. If you could turn, please, to the next page. Second page of the exhibit. Is this page a page from what is known as a trial balance?
A. Yes.
Q. And a trial balance is a printout off the general ledger system of a company that shows the current balance in the accounts; is that right?
A. Yes.
Q. And a printout of -- strike that.
Each AHERF hospital was a separate corporation in the accounting system, right?
A. No.
Q. The AHERF hospitals, at least

generally, each had separate general ledger systems; is that right?
A. There were certain exceptions to that, such as MCP. MCP was one hospital physically separated from EPPI, Eastern Psychiatric Institute. Those two were combined.
Q. The only point I'm trying to establish is it's not as though there were one consolidated AHERF general ledger. There was a whole array of general ledgers, generally speaking, one for each hospital?
A. Yes
Q. And is it the case that a printout of all the trial balances at any given point in time for all the AHERF entities would be many hundreds of pages?
MR. TORBORG: Objection.
A. These particular trial balances were, I don't know, maybe, I don't know, 25, 50 pages. Depends. The balance sheet was, I don't know, maybe 10 pages. Income statement may have been another 10, 15, something like that. Just depends how much activity that hospital had.

Q. But overall, if you were to print out a trial balance for any given date for all the AHERF hospitals, you would have many hundreds of pieces of paper, correct?
A. It depends what level of detail it's printed out. There's detailed transaction trial balances that look to be hundreds. These trial balances were more summarized and they wouldn't have been necessarily that voluminous.
As an example, I think I used to fit all my Delaware Valley trial balances into a binder, might have been a couple inches thick. Pittsburgh, maybe even same size, maybe a little smaller.
So, you know, normal, like a binder like you see at the end of the table there, that would fit all the trial balances for DVOG, and you'd need another one for the Pittsburgh side.
Q. When you're talking about fitting all the trial balances, you're talking about this high-level type of trial balance that we see in the second page of Exhibit 321, right?
A. Yes. And I had -- I had those monthly binders in my office, but they were

about the size there.
Q. All right. So if we're talking about a printout of the high-level trial balance for all of the AHERF entities, we are talking about hundreds of pages, right?
MR. TORBORG: Objection.
A. Could be. You have to add them up, I guess, but.
Q. On any given page of this trial balance printout, there are several dozen accounts listed, right?
A. Yes.
Q. So overall, we're talking about thousands of accounts in the AHERF system, right?
A. No, I wouldn't say that, because they -- we tried to have standardized chart of account. But you could have a couple hundred that would sort of apply to all the facilities. Several hundred. I never counted them.
Q. When you're talking about standard chart of accounts, you're talking about, for example, that general ledger account number 1001100 might mean the cash concentration account at each AHERF entity?

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A Right, then you go to 1201902, other reserves, FFMA, that might have only been on a handful of hospitals.
Q. But the way that the general ledgers were maintained, there's a separate general ledger account for the cash concentration account for each hospital, right?
A. Yes.
Q. So that overall, treating the accounts at the different hospitals separately, as they were on the AHERF general ledger system, there were thousands of general ledger accounts in the entire system, right?
A I guess if you add them all up. Each one of them could have had, say, 200 accounts And if you have 10 entities, if someone -- I would argue you have 200 accounts, but when you sum them all up, if you count every single general ledger. you have 200 times 10.
Q. And there are five DVOG hospitals, right?
A. Yes.
Q. University, in addition?
A Yes. Six, actually

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Q. But there are five Graduate hospitals, right?
A. I guess.
Q. There's AGH, right?
A. Yes.
Q. AHERF the parent corporation?
A. Yes
Q Other Pittsburgh-based entities?
A. Yes.
Q. The Forbes Hospitals had several different general ledgers, didn't they?
A. Yes, they did.
Q. And there's Allegheny Valley in addition?
A. Yes
Q A couple there, probably?
A Yes
Q. So overall, we're talking about maybe 20 different general ledger systems by the end of fiscal year 1997, right?
A. It could have been -- there's -- I think there was more than that.
Q. All right. More than 20 general ledgers and there are a couple hundred accounts in each. right?

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A Uh-huh.
Q So overall we're talking about thousands of different accounts in the AHERF general ledger system?
A Yeah, if you add them up collectively.
Q. And many of these accounts would have numerous transactions during the course of a given year, right?
A Yes.
Q. Let's take, as an example, a contractual allowance account An account like that would have many hundreds of transactions in a year, right?
A. Yes, it could.
Q And there would be many hundreds of entries to that account right?
A. It could I mean generally speaking, I think you had, you know, you had a standardized computer system interface that went in each month, where the billing system interfaced into the general ledger system. And then you had manual adjustments that were made
Q So there would be certain entries into the general ledger system that would be

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made through a computer interface system, and then there would be others that would be made manually, right.
A. Yes.
Q. And overall, in any year for the AHERF system, we're talking about at least hundreds of thousands of entries against the general ledger system, right?
A. It's a lot. I have no idea how much it is.
Q. Millions, maybe?
A. I have no idea.
Q. And certainly when you were an auditor, you never reviewed millions of entries in your client's general ledger system, did you?
A. No. You didn't have to review millions of journal entries. There was sometimes you looked for large entries, flip through journal entry books. I think there was audit program steps, you would do that for manual journal entries
Q. And you --
A But every single journal entry wouldn't have been examined.

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difference that you report here doesn't include any amount for MCP, right?
A. That's correct.
Q. And because of the particular bad debt reserve methodology used by MCP Hospital in fiscal year 1996 and prior years, there may well have been a significant difference between the new methodology and the old methodology in terms of what the formula reserve was; is that right?
A. There could be, yes.
Q. Then Bucks County, Elkins Park and St. Christopher's Hospitals, as of June 30th, 1996, were using two separate reserve methods; one for the Patcom accounts and one for the Envision accounts; is that right?
A. I believe that's correct.
Q. Is it the case that in this memo that you sent on February 28th, 1997, you're already assuming the Patcom write-offs have taken place, so that the comparison is simply to the Envision old method at those three United Hospitals?
A. I don't know.
Q. Let me see if I can help you with

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that. First of all, in the first page, do you see the estimated shortfall using the new method as $53,668,000?
A. Yes.
Q. Then do you see on Bates page 271, there's a February 7th, 1997 memo from you to Mr. Morrison that reports that the bad debt reserve shortfall after the projected future write-offs are extracted from the agings is $53,668,000?
A. Yes.
Q. So that this calculation that you're performing is assuming that the entire past statute and Patcom write-off has occurred, right?
A. Yes.
Q. If one were to perform a calculation of the effect of the new bad debt reserve methodology that included the Patcom accounts and the bad debt reserve method that was used there, one would get a different result for the different -- the new and old methods than the one that you reported using a different method in your February 28th memo, right?

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A. Yes.
Q. Let me hand you, Mr. Cancelmi, what was previously been marked as Exhibit 319.
Is this a memorandum that Robin Schaffer sent to you dated August 11th, 1998?
A. Yes.
Q. And it relates to June bad debt expense levels?
A. June bad debt information.
Q. And the schedule on the second page of the document contains month-to-date information, as well as year-to-date information, correct?
A. Yes.
Q. And referring you to the column actual per FS in the year-to-date section of the schedule, is it the case that the actual bad debt expense at the DVOG hospitals in fiscal year 1998 was the 38,390,000 at AUH, plus the 7,138,000 at St. Christopher's?
A. Yes.
Q. So it's a total of about $45 and a half million?
A. Yes.
Q. And that was an amount fairly

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significantly below budget, right?
A. The budget numbers were about 64 in total, something like that. 64 million.
Q. So that the actual bad debt expense was about $20 million below budget?
A. Looks like about 19.
Q. And do you recall that the bad debt allowance of the DVOG hospitals at June 30th, 1997 was about $65 million?
A. The bad debt what?
Q. Bad debt allowance.
A. On the balance sheet?
Q. Right.
A. I don't remember offhand.
Q. Assuming for the moment that that $65 million figure is correct, do these 1998 results suggest to you that the bad debt allowance as of June 30th, 1997 at the DVOG hospitals may have been on the conservative side?
MR. TORBORG: Objection.
A. Not necessarily.
Q. That's one inference that one could draw from that, though, right?
MR. TORBORG: Objection.

A. Yeah, that could be one of many others.
Q. Let me hand you, Mr. Cancelmi, what's previously been marked as Exhibit 70.
Is Exhibit 70 a March 16th, 1998 memo that you wrote to Mr. Dionisio about a Coopers & Lybrand letter on intercompany transactions?
A. Yes.
Q. And this letter, which is attached, is what's sometimes known as an agreed upon procedures report?
A. Yes.
Q. Do you see there you state in your second sentence, "essentially, C&L performed limited agreed-upon procedures, which primarily consisted of agreeing the intercompany transactions to the general ledger and verifying the mathematical accuracy of the activity."
A. Yes.
Q. And it's correct that Coopers & Lybrand performed limited agreed-upon procedures, isn't it?
MR. TORBORG: Objection.

A. Yeah, I think that's fair to say.
Q. Do you know of anything inaccurate in the agreed-upon procedures report?
A. Not that I was aware of.
Q. And the scope of the agreed-upon procedures that Coopers & Lybrand was to perform would be found in the engagement letter, correct?
A. Yes.
Q. This may be a document you were referring to before.
Let me mark as Exhibit 1129 a document with Bates number DC8368, page 6.
- - - - -
(Thereupon, Exhibit 1129 was marked for purposes of identification.)
- - - - -
Q. Do you recognize Exhibit 1129, Mr. Cancelmi?
A. Yes.
Q. What is it?
A. It's a representation letter.
Q. It's the representation letter relating to the agreed-upon procedures report for the intercompany account balances that we

looked at in the last exhibit?
A. Yeah, for intercompany agreed-upon procedures that Coopers & Lybrand performed.
Q. And is that your signature there?
A. Yes.
Q. And were the representations that you made in this letter to Coopers & Lybrand accurate and truthful?
A. Yes.
MR. TYCKO: Mr. Ryan, we would like to stop relatively soon, so whenever you get to a logical breaking point in your questioning, just let us know.
MR. RYAN: I'll do that.
Q. Let me mark, please, as Exhibit 1130 a document with Bates numbers DC8366, pages 1 to 2.
- - - - -
(Thereupon, Exhibit 1130 was marked for purposes of identification.)
- - - - -
Q. Is this a memo that you sent to Mr. Morrison dated March 23rd, 1998?
A. Yes.
Q. And it's entitled Transfer of Self

Insurance and Pension Liabilities?
A. Yes.
Q. Do you see the second paragraph there, the first sentence reads, "given the heightened awareness of the hospitals' intercompany balances in recent months, a determination was made in January 1998 to transfer the self insurance and pension liabilities back to the hospitals' balance sheet."
A. Yes.
Q. Could you explain to us what the heightened awareness of the hospitals' intercompany balances was that you're referring to there?
A. AGH had an intercompany receivable from the Delaware Valley hospitals, or AHERF, and there was questions whether AGH was going to be repaid.
Q. All right. Are the transactions that you are discussing here in your March 23rd, 1998 memo the transfer of certain assets held at the AHERF parent corporation to the individual hospitals?
A. Yeah. Certain liabilities, yes.

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Q. And that affected the intercompany account balances of the hospitals?
A. Yes.
Q. Was the timing of the transfer in January 1998 related to the fact that Coopers & Lybrand was going to issue an agreed-upon procedures report on the intercompany account balances as of January 31st, 1998?
MR. TORBORG: Objection.
A. I don't know if it was or not. I know what they wanted to do, my recollection was they wanted to, instead of having all certain items up at the parent level, they wanted to move them back to the individual hospital levels.
Q. When you say, they, who was that?
A. My understanding, management. I would have understood that from Al.
Q. Did Mr. Adamczak tell you who in management wanted to do that?
A. I thought McConnell and Abdelhak. I thought Abdelhak wanted to do that.
Q. Wasn't the purpose of this intercompany transfer to reduce the hospitals' intercompany balances that would be reported in

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the agreed-upon procedures report?
MR. TORBORG: Objection.
A. I don't know about that. No. I mean I guess, moving back, it would reduce the intercompany balances.
Q. And you're saying it's a coincidence that that occurred during the same month as the intercompany agreed-upon procedures report was going to be issued?
A. I don't know if it was coincident or not. I mean that issue had been -- AHERF management, that's what they decided to do, to transfer the liability balances back.
MR. RYAN: All right. This is a logical breaking point for the day.
MR. TYCKO: Before we go off the record, maybe we should just talk about where we go from here at this point.
I understand from my off-the-record discussions with Mr. Ryan that he is not going to be able to finish his questioning tonight, even if we stayed a little bit longer. So given that it's a Friday, 5:15, and Mr. Cancelmi has been going for three days, it seems like an appropriate stopping place.

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Do you have any suggestions, or Mr. Torborg have any suggestions for the appropriate way to bring this issue before the court?
MR. RYAN: Well, I mean I'm hopeful that we don't need to bring the issue before the court and that we can, I'm hoping, all agree that an additional day would provide me with the time necessary to complete my cross-examination and any time that Jones Day might need for the -- for any redirect questions that they might have.
MR. TYCKO: Well, I mean as we may have made clear on numerous occasions to you, we're not willing voluntarily, absent a court order, to go forward for another day. We think that would be beyond the obligations of Mr. Cancelmi under Rule 45, and would be an unreasonable burden upon him under these circumstances, given that this is now the completion of his tenth day of deposition testimony on these issues.
So I think the matter is going to have to get brought before the court. I mean are you able to make some sort of

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representation right now as to how much additional time you would need to complete your examination?
MR. RYAN: Subject to looking over my notes and the transcript so far, I believe that my additional examination would be between half a day and a day.
MR. TYCKO: Okay. Well --
MR. TORBORG: I was just going to ask if there's -- if it makes any difference, if we attempted to do this in sort of a different fashion than we're down now, either that being doing it in Dallas where's Mr. Cancelmi is located, or doing it maybe by video deposition, which is kind of a new technology.
MR. TYCKO: I don't think location is really the issue. I mean Mr. Cancelmi came to Pittsburgh voluntarily. He wasn't compelled to come here. So it isn't so much the location of the deposition that is really the issue for us.
I think it's really just the time that it takes to do the actual deposition and the burdensomeness of that at this point.
So I mean I appreciate that

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suggestion, but it seems to me that doesn't really answer the objection on our part

MR. TORBORG: To the extent that it matters, since you were asking how much time he had left, I would envision I would have -- we would have very little time, thus far, depending on what else he gets into. It's always hard for me to guess exactly, but very little time left, I mean, for re-questioning after him. But that could change based upon what he gets into.

MR. TYCKO: I don't have any problem with continuing this discussion off the record in terms of trying to work things out.

But assuming that doesn't happen and, again, working on the assumption that we would be the ones filing the motion, does anybody have any objection if we file that on or before the 28th of February? It's three weeks from now. Are you guys up against any sort of deadlines in terms of getting this issue resolved?

MR. RYAN: No, I don't have any objection to that. Let me just state that I reserve all of our rights to continue this

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examination at this time. I'm hopeful that we can continue an off-the-record discussion and hopefully resolve it that way.

VIDEO TECHNICIAN: Being there are no further questions at this time, we are going off the record. The time is 5:27.

(Deposition adjourned.)

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CERTIFICATE

The State of Ohio,)
SS:
County of Cuyahoga.)

I, Jaci R. Traver, RPR, CRR and Notary Public, duly commissioned and qualified, do hereby certify that the within named witness, DANIEL CANCELMI, was by me first duly sworn to testify the truth, the whole truth and nothing but the truth in the cause aforesaid; that the testimony then given by the above-referenced witness was by me reduced to stenotypy in the presence of said witness; afterwards transcribed, and that the foregoing is a true and correct transcription of the testimony so given by the above-referenced witness.

I do further certify that this deposition was taken at the time and place in the foregoing caption specified and was completed without adjournment.

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I do further certify that I am not a relative, counsel or attorney for either party, or otherwise interested in the event of this action.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my seal of office at Cleveland, Ohio, on this day of , 2003.

Jaci R. Traver, Notary Public
within and for the State of Ohio

My commission expires July 15, 2003.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PENNSYLVANIA

THE OFFICIAL COMMITTEE OF
UNSECURED CREDITORS OF
ALLEGHENY HEALTH, EDUCATION &
RESEARCH FOUNDATION, Civil Action
Plaintiff, No. 00-684
vs.
PRICEWATERHOUSECOOPERS, L.L.P.,
Defendant.

Continued videotaped deposition of DANIEL CANCELMI, called for examination under the statute, taken before me, Michael E. Miller, CSR, RPR, CRR in and for the State of Texas, at the offices of Gibson, Dunn & Crutcher, 2100 McKinney Avenue, Suite 1100, Dallas, Texas, on Monday, the 24th day of November, 2003 at 9:08 a.m.

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could have months in that -- within the same month where you have things going the other way.
Q. And people were, in effect, doing analyses just to find one side of the entry, and they weren't trying to track down all the 02:36PM offsetting items that went the other way?
MR. TORBORG: Object to foundation.
A. I didn't say that, no. I didn't say that.
Q. (BY MR. RYAN) Okay. Were people 02:36PM doing types of analyses to try to find the offsetting items that went the other way?
A. Yes. Yes.
Q. Well, let me ask this, now: Are you able to say one way or the other whether these 02:37PM issues of accounts at gross and out-of-period adjustments served to increase or decrease DVOG's income during fiscal year 1997?
A. I can't answer that specifically; but you've got to keep in mind, accounts at gross can 02:37PM be a different issue than out-of-period adjustments because you can have out-of-period adjustments related to accounts that were not at gross.
Q. If the accounts were adjusted, say, 02:37PM

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from one payor category to another or what? I mean, what kinds of out-of-period adjustments did you observe that weren't associated with accounts at gross?
A. All of them. You could have countless 02:38PM different situations where you have out-of-period adjustment.
Q. Can you give me one that isn't connected to accounts at gross?
A. Yeah. You could have an account, the 02:38PM gross charges are $1,000, the account gets contractualized down to, say, $400, meaning there's a $600 contractual allowance, it's on the books at $400 and, for whatever reason, that $400 a year later, six months later, 18 months later, 02:38PM gets written off. That $400 would be an out-of-period adjustment.
Q. Why wouldn't you just call that a write-off of the uncollectible account?
A. Out of period. Write-off out of 02:38PM period. That's just using terminology that's often used in the business.
Q. Isn't every write-off of an account from a previous month?
A. Not necessarily. If you collected 02:39PM

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that $400, you wouldn't have an adjustment.
Q. I understand that. It's not very common to write off an account as uncollectible in the same month in which it's established, right? 02:39PM
A. I don't know about that either.
Q. Would you agree that many accounts that are written off relate to services provided in prior months?
A. Yes. 02:39PM
Q. At all healthcare organizations?
A. Yes.
Q. That's how write-offs generally work, that you determine after some period of time that the account's uncollectible? 02:39PM
A. Yes.
Q. And you would refer to any account write-off as an out-of-period adjustment?
A. Some of them. There's a difference between a bad debt write-off and an out-of-period 02:39PM adjustment write-off.
Q. Can you explain the difference?
A. I mean, I can't. There's thousands of examples. I just went through one. You have a $1,000 account, you contractualize it down to 02:40PM

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$400 and for whatever reason, the insurance company notifies you that they're not going to pay it for -- could be countless reasons, the $400 could get adjusted as a write-off against revenue, and it's -- a lot of people view that as 02:40PM an out-of-period adjustment.
Q. Do you? Do you view that as an out-of-period adjustment?
A. Yeah.
Q. So you wouldn't consider that to be a 02:40PM bad debt write-off?
A. Not necessarily. It depends on the fact pattern. If you didn't bill the insurance company appropriately, it's contractual allowance. It's not a bad debt. 02:40PM
Q. For the reasons we're talking about earlier, that it's not really a credit quality issue, it's a billing process issue?
A. Correct.
MR. TORBORG: Object to form. 02:40PM
Q. (BY MR. RYAN) And you would expect an allowance to be taken for that kind of issue in the contractual allowance rather than the bad debt allowance?
MR. TORBORG: Object to form and 02:41PM

foundation.
A. Could be, depending on the fact pattern.
MR. RYAN: Okay We need to take a break for switching the tape. 02:41PM
THE VIDEOGRAPHER: We're off the record at 2:41 p.m. This concludes Tape 2.
(Recess taken.)
THE VIDEOGRAPHER: We're back on the record at 2:58 p.m. This is the beginning of 02:58PM Tape 3.
Q. (BY MR. RYAN) Let me hand you, Mr. Cancelmi, what's previously been marked as Exhibit 148. And if you could just take a moment to review this, let me just explain I guess why 02:59PM I'm showing this to you. Your name is not on this as author or recipient or copyee or anything, but there is a reference in the middle of the document to a meeting with Chuck Morrison and Dan Cancelmi on February 21st, 1997. So if 02:59PM you could just take a moment to review that and let me know when you're finished.
MR. TORBORG: Are you having him read the entire document, or just that paragraph? 03:00PM

MR. RYAN: Just this first page, I guess.
A. Okay.
Q. (BY MR. RYAN) Do you remember anything about this meeting that apparently 03:01PM occurred between Mr. Laing, Chuck Morrison and you about an alternative net realizable valuation approach developed by PFSG?
A. No.
Q. I've got one other document that I 03:01PM think deals with a related topic, so let me show that to you. It's Exhibit 1258.
Now, this document states in the middle of the page, the sort of double-indented paragraph, "I provided a draft of the PFSG 03:02PM valuation to NRV," which I take it is net realizable value, "to Robin Schaffer in our meeting of May 5th, 1997; she indicated she would review and comment." And then there are two pages attached, and I think the second 03:02PM attachment, Bates page 166, is the PFSG valuation to NRV.
Are these schedules at all familiar to you, Mr. Cancelmi?
A. No, not offhand. 03:02PM

Q. Do you remember anything about Russ Laing in the spring of 1997 coming up with an alternative bad debt reserving methodology?
MR. TORBORG: Object to form.
A. I really don't. I don't remember 03:03PM specifically. I know they were doing analyses, but I just -- I don't remember specifically this specific example.
Q. (BY MR. RYAN) Now, Russ Laing worked in the Patient Financial Services Group; that is, 03:03PM in the patient billing and collections department, right?
A. Yes.
Q. And it was you and others in the general accounting department who had 03:03PM responsibility for calculating and accounting for the bad debt allowance, right?
A. Yes.
Q. Did you have an understanding at the time as to why Mr. Laing was performing this 03:03PM alternative calculation of something that would appear to be within your responsibilities?
MR. TORBORG: Object to form.
A. I don't remember specifically. I know they were doing analyses because they would 03:04PM

get -- you know, they would get asked to, you know, look into -- when questions would arise, they would be asked to, you know, look into, you know, what was going on.
Q. (BY MR. RYAN) Did you have an opinion 03:04PM at the time of Mr. Laing's accounting abilities?
A. Of his what?
Q. Accounting abilities.
MR. TORBORG: Object to form.
A. He didn't work for me. 03:04PM
Q. (BY MR RYAN) You had occasion, though, to interact with him, right?
A. Yes.
Q. And in the interactions that you had with him, whether in person or in memos that you 03:04PM exchanged with him, did you have occasion to form an opinion as to his abilities as an accountant?
MR TORBORG: Object to form and foundation.
A. Not necessarily. The only thing I 03:04PM said earlier, that, you know, sometimes they would draw conclusions that, you know, we would scratch our head at, but I didn't supervise him, so I couldn't draw a specific whether he was, you know, the best accountant or the worst accountant 03:05PM

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or middle of the road.
Q. (BY MR. RYAN) Did you believe at the time that Mr. Laing was approaching some of these issues with a view toward making the performance of new management in the Patient Financial 03:05PM Services Group look good?
MR. TORBORG: Object to form.
A. I wouldn't say that. The -- you know, a lot of people's sense was that, you know, they believed that some of the problems related to the 03:05PM fact that, you know, the billing departments had been transferred over from the Delaware Valley, and, you know, that they were trying to, you know, clean up past problems.
Q. (BY MR. RYAN) Did you and others in 03:05PM your group find Mr. Laing a difficult person to work with?
MR. TORBORG: Object to form and foundation.
A. Yeah, sometimes he was. He had his 03:06PM point of view and we had ours.
Q. (BY MR. RYAN) Do you know whether there were periods of time when Mr. Laing was absent from his work at AHERF for reasons to do with his personal life? 03:06PM

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MR. TORBORG: Object to form and foundation.
A. I think I remember hearing something about that.
Q. (BY MR. RYAN) That there were times 03:06PM when he wasn't able to come to work?
MR. TORBORG: Object to form and foundation.
A. I don't know specifically. I vaguely remember hearing certain things, but I can't 03:06PM comment about that stuff.
Q. (BY MR. RYAN) All right. I mean, I'm not trying to -- you know, to get you to tell me whether rumors were true or not. I'm just trying to establish that you did hear at the time that 03:07PM there were going on in Russ Laing's life that from time to time that prevented him from coming to work; is that right?
MR. TORBORG: Object to form, foundation. 03:07PM
A. Mr. Ryan, I know Russ; I worked with him a little bit Anything I heard about his personal life would have been second, third, fourth, who knows how many hands down the road, so, you know, I don't know what was going on in 03:07PM

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his personal life. And whether that was the reason he may have been at work -- I don't even remember the exact time frame when he may or may not have been at work.
Q. (BY MR. RYAN) Okay. All right. So I 03:08PM take it, looking at these two exhibits, 148 and 1258, hasn't helped to refresh your recollection as to any work that Mr. Laing or others may have been doing on an alternative bad debt reserving methodology? 03:08PM
A. I mean, I knew they were doing, you know analyses. I just -- I don't remember specifically these, but you just -- you know, just interacting here that, you know, they're doing -- they're looking at some things, and I 03:08PM have schedules in my files for some things they'd put together on how they analyzed things. In fact, we looked at one not too -- you know, a few minutes ago. So they -- you know, they would analyze information. I mean, that was -- I 03:08PM believe that was his job.
Q. All right. When you said we looked at one, you meant some of these accounts at gross schedules we looked at?
A. Yes. 03:08PM

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Q. Well, let me ask you this, which is really what I'm trying to get at, I guess.
Did you ever review loss percentages or bad debt reserving methodologies that Mr. Laing generated in this 1997 time frame? 03:09PM
A. I'm sure I did.
Q. Okay.
A. He used to -- because one of these has arrows pointing or something. Yeah. He put together schedules like that periodically. I 03:09PM don't remember every single one of them, but that's -- I recognized that when I saw that because he did that on a lot of his schedules.
Q. Did you form any views at the time as to whether the bad debt reserve methodologies 03:09PM that Mr. Laing was generating were reasonable or not?
MR. TORBORG: Object to form and foundation.
A. I don't remember specific ones. I 03:09PM know I would have looked at some things and, you know, I'd have comments on some things, but I don't remember the specific calculations. I -- my recollection was more in putting together analyses on the accounts at gross. Those seemed 03:10PM

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to be the more frequent ones, but then I know he did do other things. He used to put together analyses periodically for -- I don't know if it was for Dionisio or Greg Snow.
Q. (BY MR. RYAN) All right. Let me switch gears here a little bit and hand you a document that's previously been marked as Exhibit 60. 03:10PM
And maybe it would be helpful to look at this in conjunction with the consolidated audited financial statements of AHERF for fiscal year 1997, which is Exhibit 58; so let me hand you that too. 03:11PM
Do you recognize Exhibit 60, Mr. Cancelmi? 03:12PM
A. Yeah, vaguely.
Q. Do you recall that Chuck Lisman maintained report makeup binders for the fiscal year 1997 financial statements?
A. Yeah. 03:12PM
Q. And for those of us who aren't accountants, a report makeup binder is basically a backup for the statements; is that right?
A. It summarizes how certain of the numbers are sum- -- are prepared or added up to 03:12PM

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get to the numbers that are in the financial statement.
Q. All right. So, I mean, does this Exhibit 60 look to you like a copy of a portion of Mr. Lisman's report makeup binder? 03:13PM
A. Yes.
Q. If we look here on the first substantive page of Exhibit 60, and it's Bates page 422, you see there the first line shows the makeup of a supplemental disclosure on the balance sheet, the allowance for uncollectible accounts? 03:13PM
A. Yes.
Q. And it totals there $127,424,000?
A. Yes. 03:13PM
Q. And if we look in Exhibit 58, the audited 1997 financial statements, we can see the same allowance for uncollectible accounts in that amount, $127,424,000, shown on the balance sheet on Bates page 896, right? 03:14PM
A. Yes.
Q. Now, if we look in the consolidating schedules in Exhibit 58, such as the consolidating balance sheet information on Bates page 921 -- 03:14PM

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A. 921.
Q. Page 27.
A. Oh.
Q. Sorry. In Exhibit 58 in the audited financial statements, these are the consolidating schedules attached to the audited financial statements. 03:14PM
A. Okay.
Q. -- we see there there's a makeup of the net patient accounts receivable for AHERF in the amount of $367,061,000, right? 03:14PM
A. Yes.
Q. But just the way that the consolidating balance sheet schedule is presented, there's no makeup information for the allowance for uncollectible accounts or bad debt reserve, there's no breakdown of how the $127 million figure relates to different AHERF entities, right? 03:15PM
A. Correct. 03:15PM
Q. And that's what's shown here in the report makeup binder in Exhibit 60; is that right?
A. Yes.
Q. So we can see here, for example, that 03:15PM

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of the $127 million, 68 million and change was at the Delaware Valley, right?
A. At DVOG.
Q. At DVOG, yes.
A. Yes. 03:15PM
Q. And that was then the figure that was calculated by the AHERF finance department as the bad debt allowance at DVOG and presented to Coopers & Lybrand to audit, right?
A. I assume it ties to the general ledger. 03:16PM
Q. Now, the next page, Bates page 23, page 423 of Exhibit 60, there's a breakdown of the assets limited or restricted as to use components by AHERF entity, right? 03:17PM
A. Yes.
Q. The first row is unrestricted by boards of trustees, future addition or replacement of property and equipment.
Is that what is generally referred to as funded depreciation? 03:17PM
A. Yes, or board-designated.
Q. And we see there the total for consolidated AHERF is $215,211,000, right?
A. Yes. 03:17PM

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PENNSYLVANIA

THE OFFICIAL COMMITTEE OF
UNSECURED CREDITORS OF
ALLEGHENY HEALTH, EDUCATION &
RESEARCH FOUNDATION, Civil Action
Plaintiff, No. 00-684
vs.
PRICEWATERHOUSECOOPERS, L.L.P.,
Defendant.

Continued videotaped deposition of DANIEL CANCELMI, called for examination under the statute, taken before me, Michael E. Miller, CSR, RPR, CRR in and for the State of Texas, at the offices of Gibson, Dunn & Crutcher, 2100 McKinney Avenue, Suite 1100, Dallas, Texas, on Tuesday, the 25th day of November, 2003 at 9:03 a.m.

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do need to go through all those procedures.
And then one of the -- as I mentioned, one of the steps is then to look at the slope and how the accounts are reserved throughout the aging categories and the reserve percentages. 11:18AM
Q. (BY MR. TORBORG) In fact, looking at the reserve percentages is one of the principal things one does as an auditor when they try to assess the adequacy of the bad debt reserves?
MR. RYAN: Objection. 11:18AM
A. Yeah, sure, they look at the reserve percentages.
Q. (BY MR. TORBORG) I mean, you don't have the opportunity as the auditor to review every single account to see whether it's truly 11:18AM collectible or not, right?
A. No.
Q. So you have to rely on some sort of -- some sort of other mechanism to determine whether or not the allowance appears reasonable, right? 11:18AM
A. Yes.
Q. When you say "slope of bad debt reserve percentages across the agings," what does that mean?
A. Let me think of an example. You could 11:19AM

have -- say you think you're going to collect -- say you have a $100 account and your history may suggest that, okay, the $100 account, depending on when the person makes payments on the account, whether it's a person or an insurance company, 11:19AM the farther out or the older the account gets, the slope, the incline, gets steeper. In other words, the reserve percentage can go up based on how old the account is. So a lot of organization -- as the account gets older, the 11:19AM reserve percentages increase.
Q. Just as the proposal you implemented during your time at AHERF, starting in September of '96 did, right?
A. Yes. There was a slope element for 11:20AM most of them -- yeah, actually, I guess all of them.
Q. Because it's pretty common knowledge that the older the -- generally speaking, the older the account is, the less likely it is 11:20AM collectible?
A. Generally speaking.
Q. When you were an auditor at Coopers & Lybrand auditing the various healthcare receivables for various clients, did you have 11:20AM

occasion to review, in order to assess the reasonableness of a particular client's bad debt reserves, the reserve methodologies that were used by others in the industry?
A. Hmm. I mean, I guess you draw upon 11:21AM your knowledge from your other audit clients. I'm not sure that the firm had some type of central repository where, you know, these are what the top hundred hospitals, this is how they reserve receivables. I don't remember anything 11:21AM like that, but just based on your different audit clients, you may -- "Okay. I know they do it like this, the other one does it like this." So that's sort of where you get your knowledge base from. 11:21AM
Q. And that, in fact, is something that accounting standards suggest that one might -- suggest the auditor might do in order to gain comfort on the reasonableness of an estimate, right? 11:21AM
A. Yes, that would be one way to do it.
Q. Okay. So, for example, if you were auditing two different hospital systems in the same market, say Pittsburgh, and one client had reserve percentages for Blue Cross of -- going 11:22AM

across the table, 10%, 10%, 10%, 10%, 10%, and the other one had receivables in the same payor class of 10%, 20%, 30%, 40%, 50%, 60%, you might take a look at the differences there in evaluating the reasonableness of either one of 11:22AM those hospitals, right?
MR. RYAN: Objection.
A. Yes.
Q. (BY MR. TORBORG) That's something that auditors do, right? 11:22AM
MR. RYAN: Objection.
A. They can. Sure.
Q. (BY MR. TORBORG) And did you view that as something Coopers & Lybrand did when it audited healthcare receivables? 11:22AM
MR. RYAN: Objection.
A. Yes. I mean, they -- you know, we would try to look at, you know, the bad debt reserve calculations to -- in a number of different -- in performing a number of different 11:22AM steps to try to get comfortable with, you know, the bad debt reserving practices for a particular hospital, taking into consideration, obviously, these facts unique to a particular hospital.
Q. (BY MR. TORBORG) Now, another test 11:23AM

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that you indicated you might use in auditing the allowance for bad debts to determine its reasonableness was subsequent receipts testing?

A. Yes.

Q. Can you explain what subsequent 11:23AM receipts testing is and how it would be used as a tool to evaluate the reasonableness of the allowance?

A. Say you have a June 30th year-end, so you're auditing the June 30th receivables. So 11:23AM what you would do is you'd look for cash payments received in, say, the month of July, August, September, October, et cetera, to see how much of that June A/R balance had been collected after year-end. 11:23AM

Q. And the -- I take it, then, that the less percentage of the balance collected might account for a higher reserve?

A. It could.

Q. Was that something -- and I'm 11:24AM referring to subsequent receipts testing -- something that was readily done by Coopers & Lybrand when you were there to evaluate the adequacy of a healthcare client's allowance for bad debts? 11:24AM

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MR. RYAN: Objection to form.

A. It was done on certain clients; other clients, it was not done. And a lot of it had to do with timing of the audit.

Q. (BY MR. TORBORG) Did it also have to 11:24AM do with the relative concerns that Coopers may have had regarding the adequacy of the allowance?

MR. RYAN: Objection.

A. Whether they went to subsequent receipts testing, if they had concerns? 11:24AM

Q. (BY MR. TORBORG) Uh-huh.

A. That would be one factor.

Q. I believe you also indicated that as an auditor, you may have spoken with individuals within the billing department in evaluating the 11:25AM adequacy of the bad debt?

A. Yes.

Q. Okay. And why would you do that?

A. Well, I mean, that's the department responsible for billing and collecting the 11:25AM receivables for a hospital.

Q. Okay. And why does that fact make them a source to look at when evaluating the adequacy of receivables, the adequacy of the allowance for bad debts? 11:25AM

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A. Because they're -- I mean, they're accountable and they're responsible for collecting those receivables, and then they work those accounts on a daily basis, so they would have insight on some of the specific accounts 11:25AM and/or trends, overall trends for particular payors that may prove useful.

Q. And I think yesterday we looked at, briefly, an alternative net realizable value approach developed by Mr. Laing who worked in 11:25AM AHERF's billing office, right?

A. Yes.

Q. Okay. And I believe you said you didn't recall reviewing that at the time?

A. I don't remember the -- like I said, I 11:26AM think I testified I remember schedules similar to that, but I don't remember if that was the exact one I would have looked at.

Q. Okay Now, given the reasons you've stated as to why the auditor may go to the 11:26AM billing department in evaluating the adequacy of the allowance, such as their ability to trace payment histories, the day-to-day contact with accounts, wouldn't an alternative net realizable value approach developed by someone within that 11:26AM

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department be a useful tool?

MR. RYAN: Objection.

A. Could be.

Q. (BY MR. TORBORG) Particularly if it was based on some sort of analysis of past 11:26AM payment history?

MR. RYAN: Objection.

A. It could be.

Q. (BY MR. TORBORG) Now, how -- what was the last year you were on the Coopers & Lybrand 11:27AM audit team at AHERF? Was it 1994?

A. Yeah, June '94 audit.

Q. Okay. Given your experience with -- both at Coopers & Lybrand and at AHERF, if Coopers & Lybrand had come to AHERF at the end of 11:27AM the 1996 audit and said, "AHERF, your bad debt reserving methodologies are inadequate and do not make sense and we will not sign the audit opinion unless you revise them," what do you think would have happened at that point? 11:27AM

MR. RYAN: Objection.

A. I think it sort of did happen. I mean, we had to book an adjustment. But you have to -- when an accounting firm does that, you have to understand where -- what the basis for that 11:28AM

conclusion is and get an understanding of, you know, what they're -- where they're coming from to make sure that, you know, their conclusions are appropriate.

Q. (BY MR. TORBORG) Now, at some point, 11:28AM I believe at least as early as September, you developed with the assistance of perhaps others, a new bad debt reserving methodology for the Delaware Valley hospitals, right?

A. Yes. 11:28AM

Q. Right.

Now, if Coopers & Lybrand had indicated in their 1996 audit that the existing bad debt reserve methodologies were inadequate and unreasonable, do you believe that you would 11:28AM have created that methodology earlier and then tried to apply it to the balances that existed at the end of fiscal year '96?

MR. RYAN: Objection.

A. We may have. 11:29AM

Q. (BY MR. TORBORG) So it's possible, then, that -- well, strike that.

Mr. Ryan also asked you some questions about the methodology used by MCP Hospital and EPPI for reserving bad debts? 11:29AM

A. Yes.

Q. And the process, again, I believe was to reserve for self-pay balances in the patient portion of insurance receivables, right?

A. Yes. 11:29AM

Q. Okay. And I believe he asked you whether or not you believed that it was a reasonable methodology, right?

A. Yes.

Q. Okay. Now, when he asked you that 11:29AM question, did you have in front of you the information you believed would be necessary to make an assessment about whether or not it was reasonable?

MR. RYAN: Objection. 11:30AM

A. No. I -- if I remember what the question was, I think I responded this was -- the bad debt reserve was calculated in accordance with the company's policy for that particular facility at that particular point in time. 11:30AM

Q. (BY MR. TORBORG) Okay. So you don't believe that you responded that you felt it was a reasonable methodology?

MR. RYAN: Objection.

A. I -- I can't -- I don't remember for 11:30AM

certain, but I think I indicated something to the effect that I wasn't issuing opinions on the reasonableness of the specific accounts or specific methodologies. It was just this was the methodology that we used as an organization that 11:30AM was, you know, subject to review and, ultimately, audit on an annual basis.

Q. (BY MR. TORBORG) And in order to assess the reasonableness of that calculation, you might want some information such as how many 11:30AM insurance receivables were over a year old -- a year old, say, that had no bad debt reserves?

MR. RYAN: Objection.

A. That would be one -- sure, one of many things you'd look at. 11:31AM

Q. (BY MR. TORBORG) Okay. And then I think that also Mr. Ryan alluded to the possibility that there might be additional contractual allowance reserves on those insurance receivables, right? 11:31AM

A. I don't remember exactly what he said, but there could be.

Q. Okay. But you don't know whether or not, in fact, there were additional bad debt -- additional contractual allowance reserves other 11:31AM

than those reserves necessary to bring it down to the contractually agreed-upon value of the account?

MR. RYAN: Objection.

A. I don't -- my recollection is that 11:31AM there was contractual allowance reserves to adjust the accounts to what the expected amount that would be collected under the contract.

Q. (BY MR. TORBORG) Okay. Mr. Ryan also asked you some questions yesterday about the bad 11:32AM debt reserving methodologies, such as what was in place at MCP and EPPI, of reserving only on payors that may have a suspect credit quality?

A. Yes.

Q. But there are a lot of reasons why 11:32AM even a third-party payor such as Medicare, Blue Cross, creditworthy payors might reject a receivable, right?

A. Yes.

Q. If you would turn to Exhibit 32. It 11:32AM should be in your stack there. Specifically at Bates page ending 275.

MR. TYCKO: 275, you said?

MR. TORBORG: 275, yes.

Q. (BY MR. TORBORG) And does this appear 11:33AM

to be a discussion relating specifically to the adult Delaware Valley Obligated Group hospitals?
A. Page 28 -- 275?
Q. 275. If you look at page ending 286, I think you'll see a separate discussion for St. Chris. 11:33AM
A. Oh. Okay.
Q. Right.
Now, that section starts off by saying, "Allegheny University Hospitals' billing and accounts receivable performance indicators have been substantially impacted by changes in AUH's business environment and AHERF's consolidation and relocation of Patient Financial Services to Pittsburgh in 1995. AUH's payor mix has evolved to where 45% of its revenue is derived from Medicaid and Managed Care, the most difficult third-party payors," right? 11:33AM 11:34AM
A. Yes.
Q. And then if you would flip with me to two more pages in to Bates ending 277, under the section "Payor Mix," this narrative states, "AUH's payor mix is generally less favorable than the comparison group primarily because of its concentration among managed care which has grown 11:34AM 11:34AM

substantially in recent years. Perhaps no other single factor, with the possible exception of denial rates, influences accounts receivable more so than payor mix," right?
A. Yes. 11:35AM
Q. And then if you would flip with me to one more section, Bates ending 278, the next page, the last sentence of that page states, "While many of the reasons for being denied payment are intercepted through prebilling edits, other reasons for denial include," and then the next page provides a number of reasons why a bill might be rejected, right? 11:35AM
A. Uh-huh.
Q. Such as, "services provided out of network, services not authorized or lacking authorization numbers, patient's not eligible," and it goes on, right? 11:35AM
A. Yes.
Q. And then the last -- and then that paragraph below it concludes, "Many third-party payors, particularly managed care companies, are increasingly resorting to the practice of denials under complex contractual arrangements in order to deny financial responsibility for payment 11:35AM 11:36AM

altogether or to shift some portion of the claim to another insurance carrier or the patient," right?
A. Yes.
Q. Now, these factors that we've just read all deal with primarily third-party payors other than self-pay, right? 11:36AM
A. Yes.
Q. So is it fair to say that the change in the payor mix at the Allegheny University Hospitals impacted -- would have an impact on the reasonableness of management's estimate for bad debt reserves? 11:36AM
MR. RYAN: Objection.
A. That's what many people believed. 11:36AM
Q. (BY MR. TORBORG) Do you recall whether AHERF ever tried to analyze what impact this change in payor environment might have on the allowance for uncollectible accounts?
A. I'm sure there was analyses done, probably countless analyses, but I think globally, a lot of people believed that because the Philadelphia market had such a concentration of managed care insurance companies that it was more difficult to bill and collect your 11:37AM 11:37AM

receivables as opposed to some other cities where managed care hadn't necessarily gained as strong a foothold; and Pittsburgh was an example where managed care hadn't necessarily gained as strong a foothold yet. 11:37AM
Q. Do you recall whether you ever discussed with anyone at Coopers & Lybrand the possible impact on the change in the payor mix and the increased denial rates on the allowance for uncollectible accounts? 11:38AM
MR. RYAN: Objection.
A. I'm sure that was discussed. You know, it probably came up -- I mean, it was pretty evident from the numbers, but then also when there was this debate that we've talked about before about using the AGH methodology, there was one of the -- I think one of the discussion points would have been, you know, the Pittsburgh market's a little different than the Philadelphia market, so you couldn't necessarily just, you know, utilize the AGH methodology out in the Philadelphia market without looking at it, because the market conditions could be different. 11:38AM 11:38AM
Q. (BY MR. TORBORG) And, in fact, because of the more difficult market conditions 11:38AM

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A. Okay.
Q. This is an analysis of reserves, in the left column, revised 6/30/95; in the right column it's January 31st, 1996, right?
A. Yes. 04:28PM
Q. And there's the fiscal year '96 revenue adjustment shown as a negative number, a number in parentheses, and so that's a potential exposure item, right?
MR. TORBORG: Excuse me. Could I 04:29PM have that one read back?
(The following portion of the record was read.)
"QUESTION: And there's the fiscal year '96 revenue adjustment shown as a negative number, a number in parentheses, so that's a potential exposure item, right?"
MR. TORBORG: Object to form.
A. Well, I don't know if it's a potential exposure item or it was segregated, because I 04:29PM think most of that adjustment came out of the CRA accounts which is listed above, like the 11 million-five.
Q. (BY MR. RYAN) That's exactly where I'm going with this, actually. 04:29PM

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A. Oh. Okay.
Q. So if you could turn back four pages in Exhibit 2294 to DC4588, page 1 of 8.
A. Okay.
Q. All right. This is another version of 04:30PM "AHERF Analysis of Reserves," again showing 6/30/95 in the left column and January 31st, 1996 in the right column, right?
A. Uh-huh.
Q. Is that your handwriting in the upper 04:30PM right corner?
A. Yes.
Q. Could you read that, please?
A. "Summarized version."
Q. Okay. Do you see under "Hahnemann 04:30PM University Hospital, Prior Year CRA" at June 30th of 1995 of $19,500,000?
A. Yes.
Q. And if you compare this schedule with the earlier version of the schedule we were 04:30PM looking at Bates number DC4588, page 5 of 8, that's the sum of fiscal year '95 and prior year CRA totalling $19-1/2 million, right?
A. That's what it looks like.
Q. And so the balance in those two rows 04:30PM

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on DC4588, page 5 of 8, at January 31st, 1996 is $14 million, right?
A. Yes.
Q. And then on the page we were just looking at, DC4588, page 1 of 8, the balance is 04:31PM $1-1/2 million, right?
A. Right.
Q. So the decrease is $12-1/2 million?
A. Right.
Q. And as you were indicating, I think, 04:31PM that you recalled that offsets the fiscal year 1996 revenue adjustment of $12-1/2 million, right?
A. Yes.
Q. Do you recall, then, that the fiscal 04:31PM year 1996 revenue adjustments were reversed and excess CRA reserves were released into income in a similar amount; namely, $12-1/2 million?
MR. TORBORG: Object to form and foundation. 04:31PM
A. I don't know if the actual entries were reversed, but I think it was just viewed that the revenue adjustments that were made were considered to be cost report adjustments.
Q. (BY MR. RYAN) And you referred 04:32PM

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earlier to a disclosure in the AHERF financial statements, and I just want to make sure we're talking about the same thing. So --
A. You just had them.
Q. Well, let's look in 1996, since that's 04:32PM the fiscal year we're in, Exhibit 1228. In the consolidated AHERF financial statements that are included in this package, it's on page 10. It's a part of note 2, the accounting policies note.
MR. TYCKO: Do you have a Bates 04:32PM number?
MR. RYAN: Yeah. Bates number 1586.
A. Okay.
Q. (BY MR. RYAN) The last sentence reads, "Retroactive adjustments are accrued on an 04:33PM estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined," right?
A. Uh-huh. 04:33PM
Q. And that's telling the reader that, as of the balance -- as of any given balance sheet date, a reserve is established for the estimated CRA liability, and if that estimate is then too high or too low, as it turns out in a subsequent 04:33PM

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period, the difference is booked to income in the subsequent period, right?
A. Yes.
MR. TORBORG: Object to form.
Q. (BY MR. RYAN) There's no -- there's 04:33PM no prior period adjustment made. Rather, AHERF was following an accounting treatment of recording the difference between the original CRA reserve and the final amount as income in the current period, right? 04:34PM
MR. TORBORG: Object to form.
A. Yes.
Q. (BY MR. RYAN) And that's what AHERF did in fiscal year 1996 with the $12-1/2 million of excess CRA reserves at Hahnemann University 04:34PM Hospital; that is, reverse the $12-1/2 million of excess CRA reserves into income in that fiscal year, right?
MR. TORBORG: Object to form and foundation. 04:34PM
A. Yes.
Q. (BY MR. RYAN) And in your view, that's consistent with AHERF's accounting policies as disclosed in note 2 to the consolidated AHERF audited financial statements, 04:34PM

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isn't it?
MR. TORBORG: Object to form and foundation.
A. Yes.
Q. (BY MR. RYAN) And just to make sure 04:34PM we have a clear record, the revenue adjustments we're talking about that became income from excess CRA reserves properly released into income are the ones that Mr. Torborg showed you in Exhibit 1692, right? 04:35PM
MR. TORBORG: Object to form.
A. You lost me there.
MR. RYAN: Could you read that back, please?
(The following portion of the record 04:35PM was read.)
"QUESTION: And just to make sure we have a clear record, the revenue adjustments we're talking about that became income from excess CRA reserves properly reversed into income are the ones that Mr. Torborg showed you in Exhibit 1692, right?"
MR. TORBORG: Object to form.
A. The revenue adjustments -- how can I explain? The revenue adjustments that were made, 04:35PM

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I guess, earlier in the year, at the end of the year, like I said, I don't know if those actual entries were reversed and then the cost report adjustments were made, or that they were just viewed as those adjustments that were made were 04:35PM the cost report adjustments that would have been made at the end of the year.
Q. (BY MR. RYAN) All right. Let me move to my third topic, which is which is bad debt allowance as of June 30th, 1996. So if you could 04:36PM try to find -- Mr. Torborg went over these exhibits with you earlier -- Exhibit 10, which was Mr. Lisman's fiscal year 1996 year-end adjustments file, and Exhibit 136, which looks like this. 04:36PM
A. Okay.
Q. And I have what I think will be very few questions about this.
Exhibit 136 is undated, right?
A. Yes. 04:36PM
Q. And is it the case that you don't recall when in time, exactly, you prepared these analyses?
A. That's correct.
Q. If you look at Exhibit 10, Bates 04:37PM

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page 1363, Mr. Torborg asked you, I think, a number of questions suggesting that the figure of 41.0, handwritten figure in the middle of the page there, might be the same as the typed $41,635,000 figure on the first page of 04:37PM Exhibit 136.
And my question is: Is it the case that you don't know one way or the other whether those figures have any relation to each other or not? 04:37PM
A. I can't say with 100% certainty, no.
Q. And then, Mr. Torborg asked you a number of questions suggesting that at the time you and others at AHERF met with representatives from Coopers & Lybrand and discussed increasing 04:38PM the DVOG bad debt allowance at June 30th, 1996, what ended up being a $17-1/2 million adjustment, Mr. Torborg suggested that you believed at the time, perhaps, that there needed to be even more of an increase. 04:38PM
And my question to you is: Is it the case, as you testified yesterday, that it was your understanding at the end of those sessions, based on the analysis Coopers & Lybrand had done, that the $17-1/2 million adjustment was 04:38PM

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sufficient to bring the DVOG bad debt allowance at June 30th, 1996 up to an amount that was in a reasonable range?

MR. TORBORG: Object to form.

A. It was my recollection that after the 04:39PM $17-1/2 million adjustment was made, that that would take the bad debt reserve up to a sufficient level to enable Coopers & Lybrand to sign off.

Q. (BY MR. RYAN) All right. And we've 04:39PM talked before about how a bad debt allowance is an estimate and there can be a range of reasonable bad debt allowances to have, right?

A. Yes.

Q. And you're familiar, I take it, with 04:39PM the principal of FAS 5 that talks about booking reserves at the low end of a range if no figure within the range is more probable than any other, right?

A. Yes. 04:40PM

MR. TORBORG: Object to form.

Q. (BY MR. RYAN) And have you conducted -- well, strike that.

Did you conduct in 1996 any analysis designed to suggest where in a reasonable range 04:40PM

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of bad debt allowances the four scenarios you set forth in Exhibit 136 might fall?

MR. TORBORG: Object to form.

A. I don't remember.

Q. (BY MR. RYAN) Did you perform any 04:40PM type of analysis designed to determine what the low end of a reasonable range of bad debt allowances might be?

MR. TORBORG: Object to form.

A. I don't remember. 04:40PM

Q. (BY MR. RYAN) Let me turn to my last topic, which is the $23 million valuation allowance in the first quarter of fiscal year 1998. So if you could try to find, please, Mr. Cancelmi, Exhibit 316 as well as 04:41PM Exhibit 4039, the Coopers & Lybrand work paper.

A. Okay. 4039?

Q. Yes. It looks like this.

A. (Nods head.)

Q. If you could turn, please, to the 04:41PM second page of Exhibit 4039. Do you see that there are listings -- and let's start with the first hospital, which is Elkins Park. Do you see that there are listing of out-of-period adjustments for the months of July through 04:42PM

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September 1997 by payor class?

A. Yes.

Q. And then there's a total amount in the fourth column, which for Elkins Park is $251,000. Do you see that? 04:42PM

A. Yes.

Q. And do you see that that total amount does not include the medical assistance out-of-period adjustments?

A. Okay. Yes, I see that. 04:42PM

Q. And the way that the table is set up is, perhaps, a little bit confusing, but do you see that, in fact, the totals for the individual months, July, August and September, because they all sum to the total for the quarter, those 04:43PM monthly totals don't include the medical assistance out-of-period adjustments either?

A. If you float them down?

Q. Yes.

A. I don't know if they do or not. You'd 04:43PM have to add them.

Q. But you can see, for example, in August, there's such a large amount of positive --

A. Oh, yeah. 04:43PM

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Q. -- medical assistance adjustments, you really couldn't include those in the total, right?

A. Okay. Yeah.

Q. And are you aware of reasons why one 04:43PM might want to analyze medical assistance out-of-period adjustments separately from other out-of-period adjustments?

A. It has tick mark A.

Q. Yeah. I'm not sure that goes to that 04:44PM question. I think it might go to the 100% figure.

A. I'm not sure why they put it together like that.

MR. RYAN: All right. Let me mark a 04:44PM new exhibit that might shed some light on this. This can be the next exhibit number.

THE REPORTER: David, do you have the exhibit stickers?

MR. TORBORG: I'm sorry. Yes. Let's go off the record.

THE VIDEOGRAPHER: We're off the record at 4:45 p.m.

(Discussion off the record.)

THE VIDEOGRAPHER: We're back on the 04:45PM

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record at 4:46 p.m.
MR. RYAN: Let me mark, please, as Exhibit 2298, the document with Bates numbers DBR-AA 74499 through 74505.
(Exhibit 2298 marked.) 04:45PM
MR. TORBORG: 2298?
MR. RYAN: Yes.
Q. (BY MR. RYAN) Do you see this is a memo from Robin Schaffer to you, dated October 15th, 1997, on the subject of Delaware 04:45PM Valley revenue analyses?
A. Okay.
Q. And if you could look, please, at the third page of the exhibit, Bates page 501, do you see there there's a table of contractual 04:46PM adjustments posted in the first quarter of fiscal year 1998 with a final bill date of June 30th or prior?
A. Yes.
Q. Total is $10,849,000? 04:46PM
A. Uh-huh.
Q. That's the same $10,849,000 we see in Exhibit 316, the inpatient component of the valuation adjustment, right? Right?
A. Hold on. 04:46PM

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Q. Okay. Sorry. I didn't mean to rush you.
A. Yes.
Q. All right. And then Robin has in the column on the right a medical assistance column 04:46PM that totals $4,112,000?
A. Uh-huh.
Q. Is it your understanding that that is a component of the $10,849,000?
A. Yes. 04:47PM
Q. And then there's a little asterisk that reads, "Medical Assistance contractual allowances may not have a bottom line impact if the accounts receivable resided in an MA Applicant financial class." 04:47PM
A. Uh-huh.
Q. Do you have an understanding of what that means?
A. Yeah.
Q. Could you explain that to us, please? 04:47PM
A. It means that there's basically a manual reserve recorded separately.
Q. All right. So it would make sense to deduct the $4.1 million of medical assistance contractual allowances from the $10.8 million 04:47PM

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total?
A. Not in -- it could be. Depends if it's an MA -- if it was classified as MA-App; and therefore, if there was a reserve out there, then you would deduct it. If there wasn't, then you 04:47PM would not.
Q. All right. Now, if there were some amount of contractual allowances on inpatient accounts taken during the first quarter of fiscal year 1998, whether it's the $6.7 million or the 04:48PM full $10.8 million, where the gross revenue was booked before June 30th, 1997 -- are you with me --
A. Uh-huh.
Q. -- so far? 04:48PM
-- it's also quite possible that there was gross revenue booked during the first quarter of fiscal year 1998 where the associated contractual adjustment hadn't yet been taken as of September 30th, 1997, right? 04:49PM
A. Could be.
Q. Do you know whether that amount was greater or less than the 6.7 or $10.8 million?
A. Whether what amount was?
Q. Whether the amount -- 04:49PM

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A. If you're asking how much of the 10.8 was -- relates to revenue booked after June '97, is that your question?
Q. No. Let me try to ask the question in a better way. I'm not doing a good job asking 04:49PM this question.
Given how AHERF's billing systems worked, for the same reason that there were these out-of-period contractual adjustments being recorded in the first quarter of fiscal year 04:49PM 1998, there likely was gross revenue being booked in that same quarter where the amount booked wasn't just the net amount, but it was the total gross amount; that is, the net plus what should have been taken as a contractual adjustment but 04:50PM wasn't, right?
A. Not necessarily.
Q. That happened frequently from month to month in the AHERF hospitals, didn't it?
A. Yeah, but then your scenario is it 04:50PM would have been recorded in some other payor class at June, and then it flipped to medical assistance in, say, August of '97, and then you'd have negative, say, Blue Cross revenue, you'd have gross revenue, you'd have positive MA 04:50PM